THE NEW CAPITAL ISSUE MARKET IN INDIA

By

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M.A., LL.B., M.Sc. (ECON.) LONDON

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First Published 1947

To

The Memory

of

My Grandfather

N. Rama Rao

As a Token

of

Gratitude

PREFACE

This book represents an essay into a hitherto unchartered field, and I am, therefore, presenting it with a certain measure of diffidence. Nobody can be more conscious than I am of the shortcomings of this work and I would gladly welcome criticisms and suggestions from all quarters. The publication of the book has been delayed owing to various circumstances, including my deputation to London as Secretary to the Indian Delegation to the Preparatory Committee of the International Conference on Trade and Employment.

In the preparation of this book, I have received considerable encouragement and helpful advice from Mr. B. N. Adarkar, M. A. (Cantab), M.B.E., Deputy Economic Adviser to the Government of India. My thanks are also due to Mr. R. G. Mundkur, M.A., Finance Officer, Finance Department, Government of India, with whom I had several discussions on the subject matter of the book.

Finally, I may add that this work was undertaken by me in my personal capacity and has nothing to do with my official position as Under Secretary to the Government of India in the Commerce Department. The responsibility for the views expressed in this book is entirely my own.

M. A. MULKY.

INDIA HOUSE,

ALDWYCH,

LONDON.

25th November, 1946.

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CHAPTER I.

INTRODUCTORY.

This book deals with the working of the New Capital Issue Market in India, that is, the manner in which the securities mainly of joint stock industrial companies are issued to the public. It may be mentioned that no study of the working of the New Capital Issue Market in India has been published so far.* This study has been made from an examination of the capital structure of nearly 600 industrial companies, as well as from an examination of a large number of prospectuses of new company flotations.

The subject matter of this book is of great importance at the present time. Now that the war is over, plans for the economic development of the country will be under discussion. In any scheme of planned economy which is envisaged for this country, an important place must be given to the planning of investment. For, it is only by the proper regulation of investment that the industrial development of this country can be assured on sound lines. That planning of investment, in order to regulate the flow of private and public investment in such a manner as it could promote the highest and steadiest level of economic activity, is essential in the post-war period has been recognised even in England—the home of private enterprise, where the present Labour Government has lost no time in introducing a Bill, *viz.*, the Investments (Control and Guarantees) Bill in Parliament. If the Bill is passed it will give the Treasury very wide powers to control

*Reference may, however, be made to a brief study by the writer entitled "Recent Developments in the New Issue Market in India", published in the Journal of the Indian Merchants' Chamber, (Bombay), July 1942.

investments, that is, to regulate borrowing, the issue of securities, the circulation of prospectuses, etc. The Capital Issues Committee established during the war is to continue its work, and under the direction of the Treasury will more or less exercise the powers under the Bill. It will be evident from the above, that the control of investment which is envisaged in England in the immediate post-war period is to be exercised through the control of the New Issue Market. No doubt the Labour Government has also got its long-term programme under which it intends to set up a National Investment Council which will plan national investment as a whole.

Planning of investment is also receiving its due share of attention in this country. In his Budget speech on the 28th February 1946, the Finance Member, the Hon'ble Sir Archibald Rowlands said that the question of planning of investment both public and private with a view to securing the fullest and most advantageous utilization of the economic resources of the country in the interest of planned capital development was under Government's consideration and that investigation was required to determine whether a National Investment Board should be set up for this purpose, and if so, how it should be constituted and on what lines it should work. As in England, in the interim and the immediate post-war period, planned investment in India will have to be done through the control of new capital issues. Hence the need for a proper appreciation of the working of the New Issue Market in this country, which is the purpose of the present study.

CHAPTER II.

INSTITUTIONS OF THE NEW CAPITAL ISSUE MARKET.

What are the institutions of the New Capital Issue Market ? The institutions comprising this market are those concerned with the formation of joint stock companies and the issue of their securities to the public, that is, institutions like company promoters and syndicates, issuing agencies such as Issue and Investment Houses, Investment Banks and Companies, and finally, firms of Stock and Share Brokers, Investment Trusts, Insurance Companies, etc., which play an important part in connection either with the issue or the distribution of the securities.

COMPANY PROMOTERS.

The individually owned industrial establishments, so far as the large scale industries are concerned, are a thing of the past. Modern industrial enterprises require large amounts of capital, which can only be raised by resorting to the joint stock form of organization. The work of establishing a joint stock company to undertake a particular industrial enterprise is done by company promoters and syndicates. The services which the company promoters render to society and to the furtherance of the economic and industrial development of a country are rarely appreciated. Even in some of the advanced countries of the West, company promoters have come in for abuse*. It is not appreciated that it is the promoter who is responsi-

*See A. S. Dewing : Financial Policy of Corporations, (3rd ed.) 1939, p. 250.

ble for the conception or discovery of the idea to exploit the possibility of some industrial proposition. The services of the promoter do not end with the mere discovery of the idea. He has to work up the details, that is, assemble the different elements ; he has to formulate the financial plan, which he usually does with the help of an Issue House or Investment Bank ; and, finally, he has to procure the funds to put his proposition into active operation.

It is not realised that the work of the promoter entails difficulties and risks ; he has sometimes to state his whole fortune and reputation in order to make the venture a success. In the preliminary investigations, prospecting, etc., prior to the founding of the company, a lot of expenditure has to be incurred in connection with the employment of engineers, technical and other experts and the promoter has to bear all these expenses. If the company is successfully established and investors come forth to take up its shares, the promoter is duly rewarded for his work and gets back the money he has sunk in the venture. Otherwise he stands to lose not only his money but his reputation as well. No better illustration of the risks and difficulties of the promoter in India can be cited than that of Jamshedji Nusserwanjee Tata. In connection with the flotation of the iron and steel company, which is now associated with his name, the preliminary investigations were carried out by him with great difficulty and expense He had to go to Europe and the U.S.A. to get the services of expert engineers ; a great deal of precious time was then spent in prospecting, before finally the

site of the present steel works at Sakchi (now called Jamshedpur in memory of the great pioneer industrialist) was selected.* But for the enterprise and risks undertaken by Jamshedji Tata, the steel company would not have been established in this country.

The promoter if he is well endowed financially will work alone, but in the case of projects of large dimensions he usually forms a syndicate. In the West, in the case of the well organised capital markets, the promoter or syndicate gets the assistance of such institutions as Investment Banks, Issue Houses and individual capitalists, to develop the proposition and otherwise in the establishment of the joint stock company. No efforts are, therefore, spared to make the preliminary investigation of the proposition as thorough as possible, and the services of engineering, technical and financial experts, are fully utilised.

Turning to India, we find that the individual or professional promoter of the type to be found in the West is absent in this country. It must be noted that this is not due to the lack of individuals with the necessary ability and foresight to undertake flotations of industrial concerns or schemes. In view of the vast industrial potentialities of the country, individuals do come forward with new schemes or propositions to exploit some or the other particular field of industry. But they do not receive any encouragement and financial assistance from the capitalists or institutions endowed with financial resources. The few Investment Companies and Issue Houses that have come to be

*See F. R. Harris: The Life of J. N. Tata.

established in recent years in India are conservative and afraid to entertain new propositions.

The Managing Agents as Company Promoters.

In the absence of company promoters of the type to be found in the West in this country, the deficiency has been made good to a large extent by the institution of managing agents. Company promotion in India has been mostly done by them; indeed, it can be said that nine out of ten industrial concerns that are established in India owe their inception to these managing agents. The managing agents undertake the work of bringing together business opportunities and the investors. They undertake all the preliminary work in connection with the flotation of an industrial enterprise. If technical and engineering experts are to be consulted they do so; if necessary, they employ foreign technical experts to advise them. The functions performed by the Issue Houses or Investment Banks in the West, *e.g.*, in regard to the formulation of the financial plan of the new undertaking, and other ancillary work in connection with the drawing up of the Memorandum and Articles of Association, the issue of the prospectus, etc., are all performed by them. Knowing well the conditions in the investment and financial markets, the managing agents can give the appropriate advice as regards the time when the issue of the securities of the new concern should be made.

The present industrial development of this country has been in no small measure due to the initiative and

enterprise of the managing agents who have undertaken the work of promotion and pioneering of industrial concerns. Conditions in the fifties and sixties of the last century in this country were similar to those in Germany. Both countries had just started to industrialize at that time ; in both the countries there was no capital market worth the name. In Germany, capital was shy and it was due to the part played by the German Credit Banks that that country was able to industrialize in a short time. The German Banks not only assisted in the promotion of industrial undertakings but also afterwards in their financing. In India similarly, capital was shy and what the German Banks did for Germany the managing agents have done for this country.

The importance of the managing agents as promoters of industrial concerns has not ceased even to-day. To carry on the work of promotion and pioneering of industrial enterprises, the big and more prominent firms of managing agents are admirably suited. Having already under their control and management a large number of diverse industrial concerns, the partners or directors of these firms are fully experienced and conversant with the problems of industrial organization and finance. Take, for example, how well situated to-day for promotion work are such firms as Tata Sons, Ltd., Killick, Nixon and Co., Burn and Co., and Bird and Co.,—to mention only a few. Tata Sons, Ltd., of Bombay, manage and control cotton mills, an iron and steel company, hydro-electric concerns, a chemical company, an oil mill, civil air service, an aircraft

manufacturing company, an investment company, two Hotels, a building company, etc. Besides, Tata Sons, Ltd., are partners in Cement Agencies, Ltd. Bird and Co., of Calcutta, who are associated with another managing agency firm, *viz.*, F. W. Heilgers and Co., between them control or manage jute mills, coal companies, a paper mill, investment trust companies, a stone lime company, etc. And, finally, Burn and Co., also of Calcutta associated with another managing agency firm, *viz.*, Martin and Co., between them control or manage jute mills, coal companies, two iron and steel companies, railway companies, etc.

It will be seen from the above how the important managing agency firms have activities covering so many fields of industries. The directors or partners of these agency firms have, besides their own experience, the whole organization of their firms to assist them, with technical staff, statistical and research departments, etc.

It would be interesting to follow how the promotion of a new industrial enterprise is undertaken by a managing agency firm. In the promotion of any particular industrial undertaking, it is quite likely that one or more members of the managing agency firm has discovered the possibilities of the proposition; or the idea might have been suggested by an outside promoter. The firm as a whole will, however, work up the possibilities of the proposition and undertake the investigation and examination of the scheme. The proposition will be turned over for examination to the technical staff employed by the firm. If the report

of the technical staff is favourable, and the proposition is found to have chances of success, then the question of the formulation of the financial plan will be taken up. In this connection the firm will be guided by financial experts in its employment. The setting up of the financial plan of the proposition is of great importance, and those in charge of this work must be fully conversant with conditions in the capital market. Otherwise the issue might be a failure, and this would indirectly reflect adversely on the reputation and credit of the managing agency firm concerned. No managing agency firm of standing can afford to lose its reputation if its issue is not placed with the investors.

After the financial plan of the new company has been completed, the work of drawing up the prospectus, the Memorandum of Association, Articles of Association, etc., in connection with the formal incorporation of the proposition as a joint stock company, is then proceeded with. This is naturally the work of lawyers and solicitors. Some of the managing agency firms also employ legal experts to advise them. All the formalities completed, the new concern is ready to be launched and its issue placed before the public.

It is thus seen how smoothly and systematically the work of promotion is carried on by the managing agency firms. It is only after a thorough examination of the proposition and the managing agency firm is fully satisfied of the success of the venture, that its incorporation is proceeded with, and the public approached. The success of industrialization in this country has been due to no small extent to the enter-

prise of the managing agents, and the care exercised by them in the promotion of industrial undertakings.

But the promotion activity of the managing agents has not escaped criticism. It has been pointed out, for example, that our industrial growth has suffered as a result of our dependence on the managing agents for the promotion of industrial concerns. For one thing, it is pointed out that they have been very conservative, imitative, and unable to break new ground.* Secondly, it is also pointed out that even when these manging agents have showed some enterprise their activities have been restricted by their financial resources.

Is the charge of conservatism and lack of initiative to promote concerns in new lines of industry on the part of the managing agents justified ? It must be admitted that in the past, the Indian managing agency firms, especially in Bombay, in contrast to the European managing agency firms in Calcutta, had been conservative and merely imitative. With some important exceptions like Tata Sons, Ltd., the others contented themselves by promoting concerns in the same line of industry, *e.g.*, cotton textile mills. In contrast, the European managing agency firms were more interprising, as could be seen from the number of concerns promoted by them in different lines of industry. But in recent years, the managing agency firms—both Indian and European—have not been slow to take advantage of opportunities when such have presented themselves. We have only to refer to such leading firms as Tata Sons, Ltd., Birla Bros., Ltd.,

*As a proof reference is made to the multiplication of concerns in the cotton textile, jute, sugar, electric and other industries.

and Burn and Co., to see how the managing agents have promoted industrial concerns new to this country. Tata Sons, Ltd., that foremost firm of Indian managing agents, who in the past have been the pioneers in promoting such concerns as the Tata Iron and Steel Co., Ltd., and the three Hydro-electric companies, *viz.*, the Tata Hydro-Electric Power Supply Co., Ltd., the Andhra Valley Power Supply Co., Ltd., and the Tata Power Co., Ltd., have been in the forefront again in recent years by being the pioneers of civil aviation in India and by promoting the Investment Corporation of India, Ltd. (a company formed to undertake issue and underwriting business) in 1937, Tata Chemicals, Ltd., in 1939, the National Radio and Engineering Co., Ltd. (formed as a subsidiary company of the Investment Corporation of India, Ltd.,) in 1940, the Investa Industrial Corporation, Ltd. (a company formed to sponsor small industries) in 1941, Tata Aircraft, Ltd. in 1941, and Investa Machine Tools and Engineering Company, Ltd. (formed by Investa Industrial Corporation, Ltd.) in 1942. On the Calcutta side, the well known managing agency firm of Birla Bros., Ltd., broke new ground when they promoted in 1936 the Orient Paper Mills, Ltd., and the Textile Machinery Corporation, Ltd., and Hind Cycles, Ltd., both in 1939. Recently they have been responsible for the flotation of a new bank, *viz.*, the United Commercial Bank, Ltd., and a motor car factory, *viz.* the Hindustan Motors, Ltd. The well known European managing agency firm of Burn and Co., also of Calcutta, responsible in the past for the promotion of the Indian Iron and Steel Co., Ltd.,

promoted in 1937 the Steel Corporation of Bengal, Ltd., formed to undertake the manufacture of steel on a large scale.

We now come to the second criticism, *viz*., that the financial resources of the managing agents have restricted their activities and forced them to adopt a more cautious policy. It is true that the financial resources of the smaller firms of managing agents are not large. It is also true that some of the older and established firms are not so affluent as they were wont to be.* Co-operation between the managing agency firms is sadly lacking. The flotation of new large enterprises requiring large amounts of capital could have been made easy if the big managing agency firms had combined their resources. No doubt in recent years there have been a few cases of managing agency firms co-operating for certain purposes. For instance, the big merger, the Associated Cement Companies, Ltd., was formed in 1939, by the amalgamation of eleven cement companies which were under the management of Killick, Nixon and Co., Tata Sons, Ltd., C. Macdonald and Co., and the Gwalior State Trust, Ltd. A new managing agency firm, *viz.*, Cement Agencies, Ltd., (in which the managing agency firms mentioned above are holding shares) was formed to manage the merger company. Two other important instances of managing agency firms from the Calcutta side, working in association can also be given. Burn and Co., (the managing agents of the Indian Iron and

*This is more so in the case of the Indian managing agency firms, this being due to the defect in their organization. In contrast to the European managing agency firms, the Indian firms are family concerns and do not admit outside partners. The European firms are thus better placed both as regards business experience and finance. See D. R. Samant and M. A. Mulky : Organisation and Finance of Industries in India, 1937, p. 61.

Steel Co., Ltd., the Steel Corporation of Bengal, Ltd., and other concerns) are now associated with Martin and Co., (managing agents of light railway companies, coal companies, electric supply companies, etc.)—some of the partners of both the firms being common. So also for similar reasons, Bird and Co., (managing agents of jute mill companies, coal companies, Investment Trust Companies, etc.) are now associated with F. W. Heilgers and Co., (managing agents of the Titaghur Paper Mills Co., Ltd., coal companies, jute mills, etc.). In spite of the drawbacks pointed out above, the flotation of important and large undertakings in new lines of industry in recent years, *e.g.*, chemical, manufacture of steel and machine tools, radio, aircraft, etc. show that there are managing agency firms with sufficient financial resources to embark on new ventures. It must be noted that there are new entrants in the field in recent years, especially Indian firms, and these are endowed with sufficient financial resources, having as their partners or directors leading business-men and financiers.*

ISSUE AND INVESTMENT HOUSES.

After the preliminary work connected with the formation of an enterprise is completed and it is decided to launch the venture as a joint stock company, the important question of the issue of its securities or shares arises. The securities can be issued by the company directly to the investing public and subscriptions invited, or they can be issued through the intermediary of an Issue or Investment House. In England and the U.S.A., it is usual to make the issue through

*See "Recent Developments in the New Issue Market in India" in Journal of the Indian Merchants' Chamber, (Bombay), July 1942.

the Issue or Investment Houses. These institutions play an important part in both the countries in the new issue market; besides issuing the securities of joint stock industrial concerns, they also issue the securities of Governments, Local Bodies, Municipal Corporations, etc.

The work performed by the Issue or Investment Houses is more specialized in the U.S.A. than in England. In the U.S.A., for example, there are three types of Investment Houses : first, the " Wholesalers" that is, Investment Houses as typified by such great houses of issue as Kuhn Loeb and Co., J. P. Morgan and Co., Dillon Read and Co., etc., whose main business is to originate issues only; second, " Participating Houses " who occasionally originate small issues but usually participate in underwriting syndicates formed by the major groups buying issues from them and distributing the same throughout the country; and third, there are the " Retailers " or " Dealers " who supply the local needs.*

An Issue or Investment House will make an issue of securities only after a thorough examination of the company concerned with the aid of its statistical and other specialized departments. Not all issues can withstand the searching examination of the Issue House. It must be noted that the reputation of the Issue House depends on its ability to place sound issues on the market. Once the confidence of the investors is shaken, however, sound an issue might be, it would be very difficult for the Issue House afterwards to place it with the investors.

*See H. Parker Willis and B. I. Bogen : Investment Banking, pp. 26-27.

THE ISSUE HOUSE AND UNDERWRITING.

If the Issue or Investment House is thoroughly satisfied with the soundness of an issue, it may then proceed to underwrite the same. Underwriting is an important function of the Issue House, and therefore, it is of importance to note what underwriting is and what its advantages are.

When an Issue House underwrites the whole of an issue, in effect it gives a sort of guarantee to the promoters of the concern that in case the public do not subscribe to the whole issue, it will itself take up and pay for that portion of the issue not subscribed for by the public by a certain date. The consideration for the guarantee or stipulation is the underwriting commission.

The advantages of underwriting to the issuing company are obvious. If by a certain stipulated date the issue is not subscribed by the public, then the Issue House will take up the unsubscribed portion. The result is that the company gets the full amount of the capital required by it at the very start. But for the underwriting, if the whole issue was not subscribed by the public, the company on account of shortage of capital would not have been able to make a start and go ahead with the purchase of plant and machinery, constructions of buildings, etc.

The advantages of underwriting to the investors in India will become obvious in view of the past defects of company promotion in this country. Before the amendment of the Indian Companies Act in 1939, the defect in the provisions relating to minimum sub-

scription in Section 101 enabled the promoters of a new company to put the minimum subscription at which they could proceed to allotment of the shares at a low figure, with resulting disadvantages to the investors. If the whole issue was not subscribed but if the minimum amount provided was subscribed, then the promoters could proceed to allotment. Those investors whohad purchased shares would find that the new venture with the amount realised by the minimum subscription would not be able even to finance the block capital and their money was thus locked up. The defect pointed out above was sought to be removed by the amendment of Section 101 of the Indian Companies Act in 1936. The provisions relating to minimum subscription were substantially altered. The Directors of a new venture have now to see that in fixing the minimum subscription, the funds raised by the issue of shares would provide for the following, *viz.*: (1) the purchase price of any property purchased or to be purchased; (2) the preliminary expenses; (3) commission for procuring subscriptions for any shares in the company; (4) repayment of moneys borrowed by the company in respect of any of the foregoing matters, and (5) working capital.

Participation in Underwriting.

We have thus seen that both the issuing company as well as the investing public stand to gain if the capital issue is underwritten. But underwriting is more or less a risky business for the Issue or Investment Houses to undertake. If the issue is fully subscribed, the Issue House pockets the commission and has

then no connection with the issuing company; but if a substantial portion of the issue is left unsubscribed then the Issue House is called upon to take up this portion. Therein lies the risk for the Issue House. The Issue Houses, especially in England, do not wish to lock up their capital in permanent investments; hence they believe in quickly disposing off any part of the issue which they are called upon to take up.

With a view, therefore, to distribute the risks, the Issue or Investment Houses both in England and the U.S.A. form syndicates; it is usual for a number of Issue Houses to participate jointly in underwriting an issue. If the issue is unsubscribed, then each of the Issue Houses would have to take up its respective share in the joint underwriting. Sometimes an Issue or Investment House may underwrite an issue solely, but it will have a list of Participants, that is, other institutions such as Investment Trusts, Insurance Companies and other Issue Houses, who would sub-underwrite a part of the issue and who would otherwise undertake the work of distribution of the securities. An Issue House which has a permanent list of Participants can devote more attention to the work of issuing only, and the subsidiary work of distribution of the securities can be undertaken by the Participants or sub-underwriters.

The Issue House and Distribution of the Securities.

In addition to the important function of underwriting another important function of the Issue or

Investment House is the distribution of the securities. We have already referred to the fact that in order to distribute the risks, the Issue Houses form syndicates. Also that some Issue Houses having a permanent list of Participants become specialists and devote their attention mainly to the work of issue. The work of the distribution of the securities by the members of the syndicate or the Participants in an issue is done on well organized lines both in England and the U.S.A. In England, for example, the Issue Houses have a permanent clientele from among such institutions as Investment Trusts and Insurance Companies, as well as from wealthy investors. The result is that an issue is soon placed without any difficulty. We have already referred to the specialized nature of the issue business in the U.S.A. While 'the wholesalers' originate or make the issue, the Participating Houses and the "retailers" undertake the distribution of the securities throughout the country. The Investment Houses undertaking the work of distribution are well organized for this business; they are equipped with efficient sales and advertisement departments, a staff of salesmen and correspondents. The campaign of selling the securities to the investors is, therefore, done on well organized lines and the whole issue is soon easily placed.

Relation of the Issue House to Client Concerns.

An important question of special interest is the relation of the Issue or Investment House to client concerns, that is, those concerns whose issues have been sponsored by it. What is the position in England

and the U.S.A. ? In England the interest of an Issue House in its client concern ceases the moment the securities are placed with the investors. But in the U.S.A., until recently, the interest of an Investment House in its client concern continued even after the issue was placed with the investors. It was not usual to find the Investment House tendering financial advice to the client concern or taking a hand in its actual management. In many cases the Investment House was represented on the Board of Directors of the client concern. A change in the attitude towards client concerns on the part of the American Investment Houses has been observable in recent years, and they have shown a tendency to copy the practice of the English Issue Houses. The American Investment Banker is not as eager as formerly to take a seat on the Board of Directors of his client concern, because of the added liability thus incurred under the Securities Act of 1933. But he may still acquire and hold a substantial stock in the company.*

Issue Houses and Underwriting in India.

In the past the capital market in India was marked by the absence of the Issue or Investment Houses of the pattern to be found in England and the U.S.A. and which we have described in the preceding pages. It is true that underwriting of issues had been undertaken now and then by firms of stock brokers or individual financiers. But it is only in recent years that attempts have been made to establish Issue Houses

*See H. Parker Willis and B. I. Bogen ; Investment Banking, p. 37.

and otherwise to undertake the work of issue and underwriting of industrial securities on organized lines. That the Issue or Investment Houses in England and the U.S.A., play an important part in the capital markets of these countries can be seen from the fact that in London in 1937 there were 315 Issuing Houses,* while in the U.S.A. between 200 and 250 million dollars have been invested in the Investment Banking business.†

The amended Indian Companies Act of 1936 makes mention of underwriting for the first time. Where underwriters are employed, under clause (*ee*) of Section (93)(*i*), it is now necessary to state in the prospectus of a new company that in the opinion of the Directors, the resources of the underwriters are sufficient to discharge the underwriting obligations. The reason is obvious, for it is unnecessary to have an issue underwritten if as a result of its not being placed with the public the underwriters are not in a position to fulfil their obligations. That underwriting of industrial issues has been increasingly undertaken in this country in recent years can be seen from an examination of company prospectuses. The work of issue and underwriting has been mainly done by Issue and Finance Houses, Investment Companies and Trusts,—institutions that have recently come to be established in the important commercial centres, as well as by firms of stock-brokers and Insurance companies who have also interested themselves in the issue business.

*See Issuing House Year Book, 1937.

†See T. K. Haven: Investment Banking under the Securities Exchange Commission, 1940, p. 133.

Tatas who have been the pioneers in the industrial field have been in the forefront again in regard to issue business by starting the Investment Corporation of India Ltd., in 1937. This institution was established principally for the purpose of undertaking issue and underwriting business on scientific lines, the carrying on the business of an Investment Trust Company, and the promotion and financing of industrial concerns. The Corporation has a paid up capital of Rs. 1.25 crores, and so far has underwritten and sub-underwritten issues of the value of over Rs. 3½ crores.*

In the two financial centres of Bombay and Calcutta numerous institutions styling themselves as Investment Companies, Finance Houses and Companies are now undertaking the work of issue and underwriting or sub-underwriting of industrial securities. The more important and bigger of these Investment and Finance Companies have been organized as joint stock companies, either public or private, and interest themselves mainly in the issue and underwriting of securities.† The others are private partnerships and are interested mainly in sub-underwriting.

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*Among the important issues underwritten by the Corporation may be mentioned :— (1) Rs. 31,89,300 of the offer for sale of the Western India Match Co., Ltd., (1938), jointly underwritten with the Central Bank of India, Ltd., for a commission of 2½% (2) The whole of the Rs. 7,50,000 of the preference shares out of the Rs. 22,50,000 capital issued by Raza Textiles, Ltd., (promoted in 1938),—underwritten for a 2½% commission. (3) In the case of Tata Chemicals, Ltd., (promoted in 1939) out of the issued capital of Rs. 1,25,00,000 (Rs. 60,00,000 in preference and Rs. 65,00,000 in ordinary shares) the Corporation underwrote Rs. 75,15,000 (Rs. 36,75,000 in preference and Rs. 38,40,000 in ordinary shares) for a commission of 2% on both the preference and ordinary shares. (4) Out of the Rs. 10,00,000 capital issued (Rs. 5,00,000 in preference and Rs. 5,00,000 in ordinary shares) by Anil Starch Products, Ltd., (promoted in 1939) the Corporation underwrote Rs. 8,00,000 (Rs. 5,00,000 in preference and Rs. 3,00,000 in ordinary shares) for a commission of 2% on both the preference and ordinary shares. (5) The Corporation also underwrote the whole of the Rs. 5,00,000 of preference shares, out of the issued capital of Rs. 10,00,000 of National Studios, Ltd., (promoted in 1939), for a commission of 3%. (6) Out of Rs. 15,12,500 capital issued by Shri Jagdish Mills, Ltd., in 1941 the Corporation underwrote Rs. 3,50,000 in ordinary shares for a commission of 4%.

†Mention might be made of the Hindustan Investment Corporation, Ltd., of Calcutta which has an authorized capital of Rs. 50,00,000 and which underwrote the Rs. 7,00,000 in preference shares out of the Rs. 10,00,000 capital issued by the Textile Machinery Corporation, Ltd., (promoted in 1939).

It may be mentioned that underwriting of industrial issues was undertaken in the past by a few firms of stock brokers, though on a restricted scale. But in recent years, many firms have entered the field to do this business. Mention might be made of the more important of these firms of stock brokers in the principal commercial centres. In Bombay, for example, among the underwriting firms of stock brokers may be mentioned Messrs. Batliwala and Karani, and Messrs. Jivatlal Purtapshi ; in Calcutta, Messrs. Place, Siddons and Gough, Messrs. Reed Ward and Co., and Messrs. Narayandas Khandelwal and Co., and in Madras, Messrs. Wright and Co., Messrs. Dalal and Co., Messrs. Kothari and Sons, and Messrs. Newton and Co. *

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*Important issues underwritten by some of these firms are :—

(i) By Messrs. Batliwala & Karani (of Bombay) :—Rs. 7,50,000, *i.e.*, half out of the Rs. 15,00,000 capital issued by National Safe Deposit and Cold Storage, Ltd., promoted in 1936), was underwritten for a commission of 3%, the other half, *viz.*, Rs. 7,50,000 was underwritten by Messrs. Narayandas Khandelwal and Co., of Calcutta for a similar commission. Messrs. Batliwala & Karani also underwrote Rs. 3,80,000 (Rs. 60,000 in preference shares and Rs. 3,20,000 in ordinary shares) out of the Rs. 5,00,000 capital issued by Hindustan Electric and Accumulators Manufacturing Co., Ltd., (promoted in 1936) for a commission of 3%. Of the Rs. 15,00,000 capital issued by Hind Cycles Ltd., (promoted in 1939), out of which Rs. 10,00,000 (Rs. 5,00,000 in ordinary shares and Rs. 5,00,000 in Preference shares) was underwritten, Messrs. Batliwala and Karani, and Messrs. Jivatlal Purtapshi (of Bombay) jointly underwrote Rs. 7,00,000 (Rs. 2,00,000 in preference and Rs. 5,00,000 in ordinary shares) while Rs. 3,00,000 (in preference shares) was jointly underwritten by Messrs. Chimanlal Dalal and Co., and Rasiklal Maneklal —the underwriting commission paid was 1½% on preference shares and 2% on ordinary shares.

(ii) By Messrs. Place, Siddons and Gough (of Calcutta) :—Out of the Rs. 3,70,00,000 capital issued by the Steel Corporation of Bengal, Ltd., (promoted in 1937) this firm underwrote Rs. 2,25,00,000 (Rs. 95,00,000 in preference shares and Rs. 1,30,00,000 in ordinary shares) for a commission of 2% on preference shares and 2½% on ordinary shares. The rest of the capital, *viz.*, Rs. 1,45,00,000 (Rs. 1,20,00,000 in preference and Rs. 25,00,000 in ordinary shares) was underwritten by Messrs. Burn and Co., and the Indian Iron and Steel Co., Ltd., for a similar commission on preference and ordinary shares. Messrs. Place, Siddons and Gough also underwrote Rs. 50,00,000 (Rs. 20,00,000 in preference, Rs. 28,50,000 in ordinary and Rs. 1,50,000 in deferred shares) offered to the public out of the issued capital of Rs. 1,00,00,000 of Dalmia Cement Co., Ltd., (promoted in 1937) for a commission of 1% on preference shares, 2½% on ordinary shares, and Rs. 2/8 per 100 deferred shares.

(iii) By Messrs. Wright and Co., (Madras) :—Rs. 1,60,000 capital issued by Swarnavalli Estates Ltd., (promoted in 1937), was underwritten by this firm for a commission of 5%.

(iv) By Messrs. Kothari and Sons (of Madras) :—Rs. 5,00,000 of the Rs. 8,00,000 capital issued by Kothari Textiles, Ltd., (promoted in 1937), was underwritten by this firm for a commission of 2½%. Also Rs. 3,75,000 (Rs. 1,25,000 in preference and Rs. 2,50,000 in ordinary shares) of the capital issued by Balanoor Tea and Rubber Co., Ltd., (promoted in 1937), was underwritten for a commission of 5%.

(v) By Messrs. Newton and Co., (Madras) :—Out of the Rs. 6,00,000 capital issued by the Travancore Rubbers, Ltd., (promoted in 1936), Rs. 5,00,000 which was offered to the public was all underwritten by this firm for a commission of 5%.

Underwriting by individual financiers in the past as well as the present has been rare. Naturally in view of the great risks involved in underwriting, it would be beyond the capacity of any single individual, however strong he might be endowed financially, to undertake this business.*

The Indian Commercial Banks have left out discretly underwriting business. Probably they feel justified in doing so, following as they do the tenets of British orthodox commercial banking practice. But there have been a few exceptions, especially in recent years, of some of the Commercial Banks interesting themselves in underwriting business. We may mention, for example, the Central Bank of India, Ltd., which jointly with the Investment Corporation of India Ltd., underwrote in 1938 the issue of Rs. 31,89,300 of the offer for sale of the Western India Match Co., Ltd. A recent instance is that of Devakaran Nanjee Banking Corporation, Ltd., which underwrote Rs. 1 crore of the issued capital of Devakaran Nanjee Investment Corporation, Ltd.

Other institutions in recent years taking an interest not so much in underwriting as in sub-underwriting have been Investment Trusts and Insurance Companies. Investment Trusts have come to be established in India only in recent years, the Industrial Investment Trust, Ltd., started in Bombay in 1935 by the well-known firm of Premchand Roychand and Sons, being more or less the first in the field. (It must be noted that the well-known managing agency firm of Bird and Co., of Calcutta has actually been the

* In the years before the last war, men like Sir Shapurji Broacha and Chunilal Saraya in Bombay, interested themselves in the underwriting of industrial securities (See P. S. Lokanathan : Industrial Organization in India, (1935), p. 237). In recent years mention might be made of Sir Homi Mehta, the well-known Bombay industrialist and financier, who underwrote the preference shares of the Nadiad Electric Supply Co., Ltd., for a commission of 3½%.

first in the field with two Investment Trusts, *viz.*, the Investment and Finance Co., Ltd., registered as a Private Limited Company in 1896, and the General Investment and Trust Co., Ltd., registered in 1908. Following the establishment of the Industrial Investment Trust in Bombay, two important Investment Trusts were started in Calcutta in 1936, *viz.*, the New India Investment Corporation, Ltd., (under the auspices of Messrs. Ramdutt Ramkissendas), and Birds Investments, Ltd., (with which the managing agency firm of Bird and Co. is associated). Numerous Investment Trusts have been established since then in Bombay, Calcutta, Madras, and some centres in Northern India. The more important of the Investment Trusts referred to above have been known to sub-underwrite industrial issues or apply for firm shares in new issues.*

Insurance Companies play an important part in the London Capital Market, being placed on the Participation lists of the Issue Houses, and are principally interested in the sub-underwriting of issues. In recent years, Indian Insurance Companies have also become interested in the issue business, and have been known to sub-underwrite industrial issues or otherwise help in placing them.

Managing Agents and Issue Business.

We have seen in the preceding section that Issue Houses and specialised institutions like Investment Companies and Investment Trusts undertaking issue

*A few Investment Trusts have been known to underwrite issues also. For example, the issued capital of Rs. 2,00,000 of the India Cold Storage, Ltd., (promoted in 1937) was underwritten by the Investment and Financial Trust, Ltd., of Madras, for a commission of 3½%. The same Trust Company underwrote Rs. 1,50,000 of the issued capital of the Chicacole Electric Supply Corporation, Ltd., (promoted in 1937).

and underwriting business have been established in India only in recent years. We have also seen that other institutions like firms of stock brokers, Commercial Banks and Insurance Companies, in recent years have interested themselves in issue business. The question may naturally be asked as to whether, in the absence of Issue and Investment Houses in the past, there were any institutions undertaking the work of the issue of industrial securities. In earlier sections of this Chapter in describing the work of company promoters, we brought attention to the important part played by the managing agents in India in regard to the promotion of industrial enterprises. Another important function performed by them was in connection with the issue of securities of industrial concerns. This function of the managing agents, it must be noted, is still being performed by them.

To undertake the work of issue, the managing agency firms have been very well placed ; their partners or directors are experienced men and know well the conditions in the financial and other markets. Besides, their connection with other joint stock concerns, *e.g.*, banks, insurance companies, industrial and commercial enterprises, etc., is also an added advantage, inasmuch as it enables them to give the necessary advice in the initial stages of the flotation of a new industrial enterprise in regard to the kinds of security to be issued and the appropriate time of the issue and advertisement of the prospectus, etc.

We have seen that the Issue or Investment House when making a capital issue may also under-

write the same. In the past when underwriting was not much known in this country, the managing agents indirectly provided a substitute for underwriting by agreeing to take up themselves large blocks of the shares of the new concern. Besides, by using their influence, they persuaded their friends and other financiers to subscribe for substantial blocks of shares. The result was that the rest of the issue would be quickly disposed off, for the investors, seeing that the managing agents and their friends had a stake in the concern, readily subscribed for its shares. Thus industrial concerns were easily able to get their shares subscribed and raise their capital. This method has been followed even up to the present time. An examination of the prospectuses of new company flotations in recent years would show that the managing agents and their friends subscribe for substantial blocks of shares in new issues.* It must be noted that though the managing agents by taking up substantial blocks of shares of new concern have provided a sort of substitute for underwriting, yet they have rarely underwritten issues in the technical sense.†

* A few instances of important recent flotations can be given. In the case of the Benga Jute Mill Co., (promoted in 1940), the managing agents, *viz.*, Messrs. Surajmull Nagarmull, applied for Rs. 15,00,000 of the ordinary shares, *i.e.*, the whole of the ordinary issue out of the issued capital of Rs. 25,00,000 (Rs. 10,00,000 being in preference shares). In the case of the Gwalior Sugar Co., Ltd., (promoted in 1942) Govan Bros, Ltd., being the managing agents, the Directors and their friends applied for Rs. 7,35,000 (Rs. 2,00,000 in preference and Rs. 5,35,000 in ordinary shares) out of the issued capital of Rs. 25,00,000 (Rs. 7,50,000 in redeemable preference shares, Rs. 5,00,000 in preference shares and Rs. 12,50,000 in ordinary shares).

† A few examples of managing agents underwriting issues sponsored by them can be given here :—In the case of the Hindustan Bicycle Manufacturing and Industrial Corporation, Ltd., (promoted in 1939), the managing agents, *viz.*, Messrs. Industrial Syndicate, underwrote the whole of the issued capital that is, Rs. 10,00,000 (Rs. 3,40,000 in redeemable preference shares Rs. 5,50,000 in ordinary shares and Rs. 1,10,000 in deferred shares. In another case, *viz.*, that of the Steel Corporation of Bengal, Ltd., (promoted in 1937), out of the issued capital of Rs. 3,70,00,000 (Rs. 1,20,00,000 in preference and Rs. 2,50,00,000 in ordinary shares), which was all underwritten jointly by Burn and Co., Messrs. Place Siddons and Gough, and the Indian Iron and Steel Co., Ltd., the share of Burn and Co., (who are the managing agents) in the underwriting was Rs. 35,00,000 (Rs. 25,00,000 in preference and Rs. 10,00,000 in ordinary shares).

Chapter III.

METHODS OF FLOTATION.

The Prospectus Method.

The most common method followed in India by joint-stock companies to raise their capital through the issue of securities is by means of a prospectus inviting subscriptions from the public. The prospectus method has the advantage that it enables the joint-stock company to approach a large section of the investing public. The prospectus is an important document being the only source of information to the investors as regards the proposed undertaking in which they are invited to join. As we shall see below, when the Indian Companies Act was amended in 1936, new provisions in regard to the particulars to be included in the prospectus with a view to make the information contained in it as exhaustive as possible, were incorporated in the Act.

Offer for Sale.

A second method by which securities can be issued to the public is by means of an Offer for Sale. Under this method, a third party (*e.g.* an Issue House, a firm of stockbrokers, etc.) takes over a large block of a company's securities and offers it for sale to the investing public at a fixed price. This method, which is more or less similar to the first method by which the public are approached through the prospectus, is common in the London Capital Market though not so in this country. The method has certain advantages

of its own, *e.g.*, it saves the company the cost and trouble of selling the shares to the public, this work being left to the third party. With a view to protect the investing public, a new section, *viz.*, 98A, was incorporated in the Indian Companies Act by the amendment in 1936. Under the new section, a document offering shares or debentures for sale to the public shall be deemed to be a prospectus within the meaning of Section 93, and therefore has to contain all the particulars required by that Section. The person or persons making the offer shall be regarded as Director or Directors of the Company with its attendant obligations, and further will be liable in respect of mis-statements contained in the announcement of the offer for sale.

Before the amendment in 1936, the provisions of Section 93 relating to the issue and contents of the prospectus could be evaded by a company or its directors by agreeing to allot the company's shares to a third party, *e.g.*, a Finance House or a stock-broker. The third party would then offer the shares for sale to the public by means of an announcement which under the old Companies Act was not deemed to be a prospectus. The new section, therefore, puts the method of the offer for sale on the same footing as the prospectus method. It may be pointed out here that in this country the term "offer for sale" is used even in those cases where a party holding a block of shares of a company for a longer period than 6 months wishes to dispose it off by inviting applications from the public. Strictly speaking this is not an offer for sale within

the meaning of Section 98(A)*. Many examples of a party holding a block of shares in a company for a longer period than 6 months and offering the same to the public under the term of an " offer for sale " can be given†.

PRIVATE PLACING AND INTRODUCTION.

In London there is a third method by which new issues are made, *viz.*, private placing followed by an introduction on the Stock Exchange. Under this method a company making a new issue places its shares privately with the aid of its stockbrokers chiefly among institutional investors like Investment Trust and Insurance Companies, and other large investors. When the issue is placed, it is advertised in two London papers for purposes of information and then permission is sought for dealings on the Stock Exchange. This method has been popular in the London Capital Market and a considerable amount of money has been raised by companies in this manner. The method has definite advantages, inasmuch as the expenses of making the issue are considerably less than in the case of the prospectus or offer for sale methods. Legal and advertising costs are kept reasonably low, and underwriting expenses, commissions, etc., are avoided. Opportunities for deception are also reduced, for the investors interested in buying the securities, as has been referred

* Cf. Section 98A(2). " For the purposes of this Act it shall, unless the contrary is proved, be evidence that an allotment of or an agreement to allot shares or debentures was made with a view to the shares or debentures being offered for sale to the public, if it is shown : (*a*) that an offer of the shares or debentures or of any of them for sale to the public was made within six months after the allotment or agreement to allot : or (*b*) that at the date when the offer was made the whole of the consideration to be received by the company in respect of the shares or debentures had not been so received."

† The best known is that of the " offer for sale " made in 1938 of the 31,893 shares of Rs. 100 each (*i.e.*, Rs. 31,89,300 out of the total capital of Rs. 63,78,600) of the Western India Match Co., Ltd.

to above, are experienced investors like Investment Trusts, Insurance Companies and other large investors. The disadvantages should also be noted.. Though the number of shares admitted to dealings is known, the number of shares available for actual dealings is not known as large blocks of shares might be held by a few institutional investors noted above. As a consequence of the shares being closely held by few holders, the resulting artificial scarcity might push up the prices of these shares. The few holders can also easily manipulate the market in the shares against the public interest. The London Stock Exchange Committee went into the matter in regard to the use of this method and its opinion was on the whole unfavourable. The Committee expressed that it is desirable that all issues particularly those of ordinary capital, should be made by prospectus or offer for sale unless from the public standpoint the necessity or advantage of a private placing is indicated by the circumstances. *

With regard to the method of private placing and Stock Exchange introduction, it may be pointed out that one of the conditions for listing of securities on the Bombay Stock Exchange is that a company making an issue shall satisfy the Management Board of the Exchange that it invited applications from the public for at least 50% of the issue in equal proportion as to class or kind for a period of not less than three days. The company further has to satisfy the Board that the public did not apply for 50% of the number of shares

* See A. T. K. Grant : A Study of the Capital Market in Post-War Britain, 1937, p. 163

or securities issued, and that in consequence less than 50% of such shares or securities have been allotted to the public. The above conditions would naturally prevent a company from resorting to the private placing and introduction method, and though the company can place privately 50% of the issue, the other 50% will have to be offered to the public, before it can get its shares listed on the Bombay Stock Exchange. It must, however, be pointed out here that the above conditions may be waived by a majority of two-thirds of the Members of the Board, with the result that a company which has placed privately its whole issue may be able to obtain permission for the listing of its shares, though the permission would be given only after a lapse of time. Where the intention, therefore, is to list the shares of a new company immediately they are placed, the Bombay Stock Exchange would refuse permission unless their listing conditions noted above are fulfilled. It may be observed, however, that even under these limitations the private placing method has been used by a large number of companies on the Bombay side to raise their capital.

Offer by Circular to Shareholders.

There is a fourth method by which a company can make an issue of securities, *viz.*, by means of an offer by circular to "shareholders only." This method as is obvious can be used only by an established company seeking to make a fresh issue of capital. The use of this method by a company is now made compulsory in India by the introduction of a new section in 1936, *viz.*, 105C, in the amended Indian Companies Act.

Under the new section it is now compulsory for a company seeking to increase its capital by the issue of further shares to offer them to the members, *i.e.* the existing shareholders, in proportion to the shares held by each member (irrespective of class). The notice of offer must specify the number of shares to which the member is entitled, and limit the time within which the offer if not accepted will be deemed to be declined. The company can proceed to dispose of the shares offered to the members to outside investors only after the members have declined the offer or after the expiry of the time limit. This method of issue is the most inexpensive, but it can be used only by a company which has been successfully operated and whose shares are quoted at a premium. It may be noted that in recent years a large amount of fresh capital has been raised by the established industrial concerns in this country under this method.

THE PROSPECTUS.

We have seen above that the most common method followed by joint stock companies in India to issue their securities is by means of a prospectus inviting subscriptions from the investing public. We have also referred to the fact that the second method by which a company can issue its securities *viz.*, offer for sale, is more or less similar to the first method. The document under this method offering the shares to the public is to be deemed a prospectus within the meaning of section 98A of the amended Indian Companies Act, and must contain all the information as is required in a prospectus. The prospectus is the only

source of information to the investors as regards to new venture whose shares they are asked to buy. It therefore becomes necessary to make a detailed reference to this important document. The information contained in the prospectus is of two kinds :—(1) that given to comply with requirements of the Companies Act, and (2) that given to comply with established practice or the rules of the Stock Exchange.

Information Required by the Indian Companies Act.

Sections 92 and 93 of the Indian Companies Act lay down the rules regarding the issue and contents of the prospectus. When the Indian Companies Act was amended in 1936, new clauses were inserted in these sections in regard to the particulars to be included in the prospectus with a view to make the information contained in it as exhaustive as possible and thus to give an additional protection to the investing public. It might be useful to refer to the important requirements and provisions as laid down by these two sections of the Indian Companies Act.

The first important requirement is that before a prospectus is issued to the public, a copy must be filed with the Registrar of Joint Stock Companies, and every copy of the prospectus must state that a copy has been so filed. The prospectus must give the contents of the Memorandum of Association, with the names of those who have signed it and the number of shares subscribed for by them respectively. From the Memorandum of Association, the investor can find out the

nature of the new venture, and from the signatories the names of those associated with it. The names of the first Directors, and of the managers or managing agents, as well as any provision in the Articles of Association of the Company regarding qualification shares for a director and his remuneration, must also be stated. Under the amended Companies Act, it now becomes necessary to state in the prospectus any agreement for the appointment of managers or managing agents and their remuneration. The investors as a result of the amendment now know beforehand the terms under which the managing agents are appointed and the remuneration payable to them, as well as the manner in which this payment is to be made. Prior to the amendment in 1936, the investors used to be kept ignorant of the terms of the managing agency agreement; this defect has now been removed.

The prospectus must also state the minimum subscription on which the directors may proceed to allotment. This enables a subscriber to know that his application money will be refunded if the company is not able to raise the minimum amount. It must be noted that the provisions relating to the minimum subscription prior to the amendment of the Companies Act were such as to encourage the formation of mushroom companies with resulting loss to the investing public, thus impending industrial progress. The minimum subscription with which companies could be started was fixed at a ridiculously low figure. The result was that companies thus started with a low minimum subscription found that the capital raised

by them was insufficient even to finance their initial requirements, and as a consequence they had to resort to borrowing at their very inception. By the amendment in 1936 the provisions of Section 101 of the Companies Act which relate to minimum subscription have been substantially altered with a view to deter companies from starting with a low minimum subscription and obtaining the certificate of commencement of business from the Registrar easily. Though the fixing of the minimum subscription is still left to the discretion of the directors, under the amended section,* they have to see that the amount would provide for the following matters :—(1) the purchase price of any property purchased, (2) the preliminary expenses and any commission for procuring subscriptions for any shares in the company, (3) repayment of moneys borrowed by the company in respect of any of the previous matters, and (4) working capital. It may be noted that though an attempt has been made by the amendment Section 101 to put a stop to the formation of mushroom companies, much of the usefulness of the amendment has been lost by the fact that the directors have been left with the discretion to raise a part of the minimum amount other than by the issue of share capital.† Thus the old defect of the starting of companies with insufficient share capital might be repeated, and concerns will be incurring liabilities at their very start by the issue of debentures or from

* See Section 101, Clause (2).

† See Section 101, Clause (1) :—"No allotment shall be made of any share capital of a company offered to the public for subscription unless the amount stated in the prospectus as the minimum amount which in the opinion of the directors must be raised by the issue of share capital in order to provide the sums, or if any part thereof is to be defrayed in another manner, the balance of the sum required to be provided in respect of the matters specified in sub-section (2) has been subscribed, and the sum of at least five per cent thereof has been paid to or received in cash by the company."

loans granted by the managing agents. It would have been better if the provisions in the Bill as originally introduced had been accepted, and under which it would have been provided that the subscribed capital must either be sufficient to meet the expenditure for all the heads mentioned above or $33\frac{1}{3}$ per cent. of the share capital offered to the public for subscription, whichever is higher. The Bill also provided that 25% of the subscribed capital must have been paid for or received in cash by the company. The Select Committee however deleted both these provisions.*

Another particular which must be disclosed in the prospectus is as regards underwriting, that is, in those cases where the issue of shares is underwritten. The names of the underwriters are to be disclosed along with a statement that in the opinion of the Directors the resources of the underwriters are sufficient to discharge the underwriting obligations. This provision has been added by the amending Act and its importance will become obvious. When an issue has been underwritten the promoters find it easy to place the shares among the investors. This is due to the reason that the investors know that even if the whole issue is not fully subscribed for by the public, the company would call upon the underwriters to discharge their obligations and to take up the unsubscribed portion of the issue. The result is that the company can make a start immediately with the full complement of capital. But if the underwriters are not able to discharge their obligations, and it is found that the issue is not fully

*See D. R. Samant and M. A. Mulky : Organization and Finance of Industries in India, 1937, p. 272.

subscribed for by the public, then the company would be unable to start operations due to insufficient finance. The investors who have already subscribed for the shares of the company would suffer as their investments would be locked up. It is, therefore, necessary for the investors to know beforehand from the Directors that the financial resources of the underwriters are sufficient for the purpose of fulfilling their underwriting obligations.

When any property has been purchased or is to be acquired by the proposed company, the names of the vendors must be disclosed in the prospectus together with the particulars as to the manner in which the payment to the vendors has to be made, whether wholly or partly out of the proceeds of the issue. If the purchase or acquisition has not been completed at the date of the prospectus, the amount payable in cash, shares or debentures to the vendor must be disclosed. By the amending Act it is now necessary to disclose further in the prospectus, in order to judge the propriety or otherwise of the price intended to be paid to the vendor, the prices at which the property might have been transferred during the two years preceding the acquisition, and in the case where a business is intended to be purchased, the profits made during the three years prior to the acquisition must be disclosed.

The amount or estimated amount of preliminary expenses must also be stated in the prospectus. This provision will enable the investors to know as to how much money has been spent or is to be spent on pre-

liminary expenses incurred in connection with the incorporation of the company.

Other important particulars which have to be disclosed in the prospectus are :—

(1) The dates of and parties to every material contract.

(2) The interest of any Director in the promotion of the company, or in any firm which is connected with the promotion or formation of the company. (This will enable the investors to know beforehand the extent to which any Director of the company will benefit by the promotion of the company.)

(3) If the company has more than one class of shares, the right of voting at meetings of the company as well as the rights in respect of dividends and capital attached to the several classes of shares must be stated. Under the amending Act it is now necessary to state whether the Articles of the Association of the company impose any restrictions upon the shareholders' right to attend or vote at meetings of the company or the right to transfer shares as well as also any restrictions upon the Directors' power of management.

(4) In those cases where a prospectus is issued by a company already carrying on business, the amending Act provides that it must contain a report of its auditors as to the

dividends paid during the previous three years. Similarly if a new business is to be acquired the prospectus must be accompanied by a report of the accountant as to the profits made in the business during the preceding three years.

Other Additional Information in The Prospectus.

Besides the inclusion of the above particulars required by the Indian Companies Act, the prospectus would contain other information which is given to comply with established practice or the rules of the Stock Exchange. On the front page of the prospectus would be found a statement that the list of applications will be opened on a particular day and will be closed on or before another particular day. Under the Indian Companies Act it is not obligatory to state the date of opening and closing of the list of applications. It is, however, necessary to state the date of opening of the list of applications for the information of those who wish to forward their applications. The list may be closed at any time, but the provisions of Section 101(4) which in effect require that allotment, if made, must be within one hundred and eighty days of the issue of the prospectus, must be observed.

Another statement to be found on the front page of the prospectus is to the effect that the company will make an application in due course to the Stock Exchange for permission to deal in or for a quotation of its shares. The Stock Exchanges, for example, of

Bombay and Calcutta, lay down the rules which must be observed and certain formalities carried out by the company before dealings in its shares can be allowed on the floor of the Exchange. According to the rules certain particulars must be included in the prospectus ; any omission would sometimes prevent the company from obtaining the necessary permission for the quotation of its shares. It has sometimes been found that even companies promoted by some of the well known firms of managing agents have been refused permission to have their shares listed on the Stock Exchange concerned because of their omission to include the necessary particulars in the prospectus. One important statement that must be included in the prospectus, under the rules of the Stock Exchange, is as regards brokerage, that is, the commission which must be paid to approved brokers, *e.g.*, members of the Stock Exchange who help to place the shares of the company among the public. Now under the rules of the Calcutta and Madras Stock Exchanges, the commission which must be paid to brokers must be a certain percentage of the value of the shares applied for and allotted, and if the full commission is not paid the shares are not eligible for a quotation. No such rule is, however, found in the case of the Bombay Stock Exchange.

If the proposed company is under the patronage of an Indian State, this is also prominently stated on the front page of the prospectus together with the details of any valuable concessions from the State concerned.

The prospectus will also give the name of the Bankers of the company. If arrangements are made with the Banks to receive applications for shares on behalf of the company, this will be stated. The names of the Solicitors to the company will appear below that of the Bankers. If certain types of investors are to be given preferential treatment as regards their applications for shares this will be stated. This provision is made with a view to enable small investors to subscribe for shares. If any firm applications for shares have been received this will be stated on the front page of the prospectus. It is generally found that the Managing Agents, Directors and their friends take up firm substantial blocks of shares of a new undertaking. In some cases, the Provincial Governments or Indian States also take up blocks of shares of the issue. The reason for the inclusion of a statement in the prospectus that substantial blocks of shares have already been taken firm is to instil confidence in the minds of the public who will then readily subscribe for the remainder of the issue.

Other particulars included in the prospectus are as regards the manner in which applications for shares must be made, the manner in which share certificates will be issued in respect of shares allotted, and the address from where copies of the prospectus may be obtained.

CHAPTER IV.

TYPES OF SECURITY.

SHARES AND DEBENTURES.

Two broad types of securities can be issued by a joint stock company, *viz.*, shares and debentures. The shares represent ownership and the debentures creditorship in the company. The shares are sub-divided into three main classes, *viz.*, ordinary, preference and deferred.

We have seen in an earlier section that one of the important functions of the promoter is the formulation of the financial plan of the company. In the well developed capital markets of the West, he is assisted in this task by such institutions as Issue and Investment Houses. In deciding the form of capital issue, *viz.*, whether the necessary capital should be raised by the issue of ordinary or preference shares, or debentures, various factors have to be taken into account. The type of concern, the general economic conditions and the state of the financial markets,—all these factors will play an important part in the determination of the form of capital issue. Further, in India the problem would be complicated by the aptitude of the investing public. The proverbial shyness of the Indian investor is well known. Particular sections of the investing public show their predilection for only certain types of securities. The business community, for example, would prefer to invest in the ordinary shares of a concern and thus take a part in its control as well as share in its profits. The middle classes, *e.g.*,

those employed in Government offices, Banks and the Commercial firms, would prefer to invest in the type of security which would give them a fixed return, *viz.*, preference shares. Institutional investors and other large investors such as Indian Princes, etc., who do not wish to be associated with the management of companies but be assured of a safe and fixed return would prefer to invest in debentures.

In view of what has been said above it is difficult to lay down general principles as regards the formulation of the financial plan of a company. But some guiding rules can be followed. It is not advisable, for example, to burden a company in its initial stages with fixed interest charges on its income, say by the issue of debentures. This type of security can be issued at later stages when the company has proved itself successful and is in need of additional capital.

An idea of the form under which capital of the different industries in India has been raised can be had from the following table :—

METHODS OF RAISING NEW CAPITAL.

Name of Industry.	Total number of cos.	Total paid up capital (including debentures) Rs. lakhs.	Ordinary Capital.		Preference Capital.			Deferred Capital.			Debentures.		
			Rs. lakhs.	% of total capital.	Number of cos. issuing.	Rs. lakhs.	% of total capital	Number of cos. issuing.	Rs. lakhs.	% of total capi-tal.	Number of cos. issuing.	Rs. lakhs.	% of total capital.
Jute	61	21,54	13,04	60·54	49	6,22	28·87	1	(a)	.01	21	2,28	10·58
Cotton Mill:													
Bombay Centre ...	44	13,16	11,47	87·16	7	96	7·29	3	56	4·26	2	17	1·29
Ahmedabad Centre	28	2,88	2,12	73·61	10	69	23·95	1	(b)	·01	1	7	2·43
Other Centres ...	95	18,52	14,58	78·72	40	3,22	17·39	5	9	·49	12	63	3·40
Total Cotton Mill ...	167	34,56	28,17	81·51	57	4,87	14·09	9	65	1·59	15	87	2·81
Iron & Steel ...	5	20,44	8,74	42·76	2	8,89	43·49	2	20	·98	2	2,61	12·77
Engineering & Construction	25	4,73	3,36	71·04	10	1,24	26·21	2	3	·64	3	10	2·11
Coal	55	5,63	4,95	87·94	9	43	7·63	...	...	...	3	25	4·43
Electric	70	22,87	16,82	73·54	27	3,94	17·23	...	...	...	18	2,11	9·23
Tea	133	5,84	5,24	89·73	23	51	8·73	...	...	...	5	9	1·54
Cement	4	13,35	12,25	91·76	2	40	2·99	1	5	·38	2	65	4·87
Sugar	49	9,60	6,40	66·67	23	1,72	17·91	1	2	·21	21	1,46	15·21
Chemical	7	3,64	2,31	63·46	5	1,13	31·04	1	2	·55	2	18	4·95
Paper	8	3,06	1,77	57·84	5	68	22·23	...	...	...	5	61	19·93
Steamship	6	3,39	3,06	90·27	2	18	5·31	...	...	...	1	15	4·42
Timber	4	1,16	1,11	95·69	1	3	2·58	...	...	...	1	2	1·73
Match	2	77	77	100·00	...	...	...	...	...	...	...	...	...
Radio & Cable ...	1	72	54	75·00	...	...	...	1	18	25·00	...	...	...
Total ...	597	1,51,30	1,08,53	71·73	215	30,24	19·99	18	1,15	·76	99	11,38	7·52

(a) Rs. 30,000 only.

(b) Rs. 3,000 only.

It will be seen from the table that our industries have raised their capital by issuing the four types of securities. A detailed examination of the table will show how each industry has been able to raise the necessary capital. In the jute industry, for example, 60.54% of the total capital has been raised by the issue of ordinary shares, 28.87% by the issue of preference shares, 10.58% by the issue of debentures and 0.1% by deferred shares. The industry as a whole has more or less a balanced capital structure. The table will also show that out of the 61 concerns as many as 49 have issued preference shares and 21 concerns have issued debentures.

In the cotton mill industry as a whole it will be seen that 81.51% of the total capital has been raised by the issue of ordinary shares, 14.09% by preference shares, 2.81% by debentures and 1.59% by deferred shares. An examination of the cotton mill industry at Bombay, Ahmedabad and other centres will show that the methods of raising capital at these centres has not been uniform. For example, at Bombay centre as much as 87.16% of the capital has been raised by the issue of ordinary shares and only 7.29% by preference shares. It is interesting to note that in Bombay only 1.29% has been raised by the issue of debentures. Attention should be drawn to the proportion of deferred capital which is 4.26%; this probably represents the payment to the vendors of the mill concerns in the past when the mills, which were on a proprietory basis, were converted into joint stock companies. At Ahmedabad centre, the proportion raised by ordinary shares is

as high as in Bombay, *viz.*, 73.61%, but a larger proportion, *viz.*, 23.95% has been raised by preference shares. The proportion raised by debentures is small, *viz.*, 2.43%. In the centres outside Bombay and Ahmedabad, the proportion of capital raised by preference shares is 17.39%, while the proportion of ordinary share capital, though less than in Bombay, is higher than in Ahmedabad being 78.72%, and a larger proportion of the capital, *viz.*, 3.40% has been raised by debenture issues.

The iron and steel industry has raised a rather larger proportion, *viz.*, 43.49% of its capital by the issue of preference shares. Together with the debenture capital representing 12.77% the total proportion of fixed interest bearing capital would thus be 56.26%. The industry has thus to carry a heavy load of interest charges, and this accounts for the criticism levelled against the capitalization of this important industry. Indeed, one concern, *viz.*, the Tata Iron and Steel Co., Ltd., has 73.5% alone of its capital in preference shares.* Of course, it must be pointed out in all fairness to this concern that but for the issue of preference shares at the time of its foundation at high rates of interest, the requisite capital would not have been forthcoming. Considering the pioneering nature of the industry and the risks involved, the investors could not be coaxed otherwise than by the offer of high rates of interest on the preference shares.

* This defect in the capitalization drew the attention of the Govt. of India. Cf. the letter of Mr. D. T. Chadwick, Secretary, Government of India, Commerce Department, to the Tata Iron and Steel Co., Ltd., "I am to draw pointed attention to the fact that the arrangement of capital whereby 74% of the share capital consists of cumulative preference shares whereby more than 90% of these cumulative preference shares bear the high rates of 7½% cannot be regarded as satisfactory." See Indian Tariff Board, Steel Enquiry, 1926, Vol. II, p. 335.

The paper industry has also a high proportion of its capital in fixed interest bearing securities, *viz.*, 19.93% in debentures and 22.23% in preference shares, forming together 42.16%. In the engineering and construction industries, a good proportion, *viz.*, 26.21% has been raised by preference shares, but the proportion raised by debentures is small, *viz.*, 2.11%.

The chemical industry comes second only to the iron and steel industry in regard to the raising of a fairly high proportion, *viz.*, 31.04% of its capital by the issue of preference shares. But the proportion of capital raised by this industry through the issue of debentures is 4.95% as compared with the 12.77% in the case of the iron and steel industry.

Other industries, besides the cotton textile industry, which have relied more or less exclusively on ordinary shares to raise their capital are, the coal, tea, cement, timber and steamship. The match industry has relied exclusively on ordinary shares to raise its capital. Attention should be drawn to the large proportion of deferred shares, *viz.*, 25% in the case of the radio and cable industry.

The table will show that excepting the match, and the radio and cable industries, all the other industries have raised their capital by the issue of the three important types of securities, *viz.*, ordinary shares, preference shares and debentures. We have already seen that the match industry has ordinary shares only. The radio and cable industry has no preference share and debenture issues. It will be found that out of the total capital of Rs. 151 crores

raised by the 597 industrial companies examined by us, Rs. 109 crores or about 72% has been raised by the issue of ordinary shares, Rs. 30 crores or about 20% by the issue of preference shares, Rs. 1 crore or about 1% by deferred shares, and Rs. 11 crores or 7% by debentures.

Rights and Privileges of the Different Types of Security.

We have seen above that a joint stock company in order to raise its capital can issue four types of security, *viz.*, ordinary shares, preference shares, deferred shares and debentures. Each of these four types of security have their own sub-divisions with their attendant rights and privileges. In England and the U.S.A. where industrialization has advanced much the joint stock form of organization has assumed complications. This will be evident from the complicated rights and privileges attending the four main types of security referred to above. In India, where industrialization has not advanced to the same extent as in England and the U.S.A. the joint stock form of organization is still simple. An examination, however, of the securities issued by recent company flotations would show that the joint stock form of orgnization in this country also is assuming complications. This development would no doubt indicate that the Indian investors are becoming conversant with the complexities of the joint stock form of organization of industrial concerns.

The ordinary share is the simplest to understand. The holder of ordinary shares knows that he shares in the profits of the company after prior charges have

been met, and that being given the right to vote, he can exert an influence on the management of the company. As a matter of fact his interests and those of the company are common. The right to vote the ordinary shareholder of course shares with the preference and deferred shareholders. But as regards his right to share in the profits of the company, he comes next to the debenture holders and the preference shareholders, but prior to the deferred shareholders. Though not to the same extent as the preference shares, ordinary shares have also come to be divided into sub-classes. The division of ordinary shares into "A" and "B" is rather common in this country. Actually there is not much difference between these two classes in so far as rights are concerned, but their denominations may not be the same. One concern, *viz.*, the Titaghur Paper Mills, Ltd., has actually three classes of ordinary shares, *viz.*, preferred ordinary of Rs. $2\frac{1}{2}$ each, and "A" and "B" ordinary of Rs. 5 each. The preferred ordinary shares of this company are entitled to a fixed preferential (tax free) dividend of 10% per annum out of the profits which remian after paying the dividend on the preference shares. Besides, these shares carry certain rights in a winding up in common with the other two classes, *viz.*, "A" and "B" ordinary. These latter two classes rank *pari passu* with each other in all respects except in voting power. Another concern, *viz.*, the Madhowji Dharamsi Manufacturing Co., Ltd., (of Bombay) has a class of ordinary shares called "Conversion" shares. The only special feature of these "Conversion" shares is that in a winding up they have a preferential claim to repayment of capital over

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the other class of shares of the company, *viz.*, the deferred. Some concerns have, besides the ordinary shares, other classes of ordinary shares bearing such names as "Employee" shares,* "Canegrowers" shares,† "Agriculturists" shares,‡ "Medical" shares,§ "Management" shares, §§ etc.

It is only when a company issues deferred shares that the ordinary shares obtain a right to a preferential dividend over the deferred. In such cases, therefore, the ordinary shares attain the status of the preference shares, with this difference that the preferential dividend to which they are entitled is not cumulative. Of course, their right to a preferential dividend comes next to the right of the preference shareholders and the debenture holders.

The rights of the ordinary and deferred shareholders to share in the profits of a company can be arranged in many ways. For example, in some cases it is arranged that after a dividend of say 10% or $6\frac{1}{4}$% has been paid on the ordinary shares, the deferred would be entitled to a similar dividend, and any surplus would be equally divided among the ordinary and deferred shareholders**, while in other cases it is provided that after a certain dividend of say 3% or 6% has been paid on the ordinary shares, any surplus profits would be equally divided between the ordinary

* *e.g.*, the Mysore Spinning and Manufacturing Co., Ltd.

† *e.g.*, Jeypore Sugar Co., Ltd.

‡ *e.g.*, Vizagapatam Sugar Co., Ltd., (Madras).

§ *e.g.*, Bengal Chemical and Pharmaceutical Co., Ltd.

§§ *e.g.*, Clive Buildings, Ltd., (Calcutta).

** *e.g.* in the case of South Bihar Sugar Mills, Ltd., R. G. Cotton Mills Co., Ltd., Indian United Mills Ltd., and New Victoria Mills Co., Ltd. It may be noted that in the case of the New Victoria Mills Co., Ltd., any surplus divisible profit remaining after the dividends are paid are to be apportioned in three equal parts for payment of further dividends to the preference, ordinary and deferred shareholders.

and deferred shareholders.* In some instances, it is provided that after the payment of, *e.g.*, 8% on the ordinary shares, the deferred are entitled to a dividend of 25% and any surplus profits would be equally divided between the ordinary and deferred shareholders.† A rather uncommon arrangement is where the ordinary and deferred shares rank *pari passu* in the matter of the distribution of the profits.‡

As regards the repayment of capital in a winding up, the rights of the ordinary shareholders come next to the debenture holders and preference shareholders but prior to the deferred shareholders.§ It would be interesting to know as to what the rights of the ordinary and deferred shareholders are in the division of the surplus assets of a company after the whole of the paid up capital has been paid off. (Of course, where there are no deferred shares all the surplus assets would go to the ordinary shareholders, excepting in those cases where the preference shares carry the right to participate in the surplus assets.) The most common arrangement seems to be where the ordinary and deferred shareholders participate equally, that is, each class receiving one-half of the surplus assets.** A rather uncommon arrangement is where the preference, ordinary and deferred shareholders rank *pari passu* in the participation of the surplus assets.††

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* *e.g.*, in the case of Indian Steel and Wire Products, Ltd., Indian Malleable Castings Ltd., Assam Bengal Cement Co., Ltd., and Indian Radio and Cable Communications Co., Ltd.

† *e.g.*, in the case of the Tata Iron and Steel Co., Ltd.

‡ In the case of Madhowji Dharamsi Manufacturing Co., Ltd. (Bombay).

§ There are a few exceptions where as regards the repayment of capital in a winding up the preference, ordinary and the deferred shareholders rank *pari passu* (*e.g.* in the case of the R. G. Cotton Mills Co., Ltd.,), or the ordinary and deferred shareholders rank *pari passu* (*e.g.* in the case of the Assam Bengal Cement Co., Ltd.).

** *e.g.*, in the case of Indian Steel and Wire Products, Ltd., Indian Malleable Castings Ltd., Assam Bengal Cement Co., Ltd., and Indian Radio and Cable Communications Co., Ltd.

†† *e.g.*, in the case of R. G. Cotton Mills Co., Ltd.

As compared with the ordinary shares, the rights and privileges of the preference shares are more complex. The following table will give an idea of the rights and privileges of preference shares of 215 Indian industrial companies examined by us :—

DISTRIBUTION OF PREFERENCE SHARE ISSUES OF COMPANIES ACCORDING TO RIGHTS AND PRIVILEGES.

Name of Industry	No. of cos. issuing	No. of issues	Cumulative.	Tax free	Preferential claim to Repayment of Capital in winding up	Redeemable	Participating in profits	Participating in Surplus Assets in winding up
Jute	49(a)	51	51	50	48	6	3	...
Cotton Mill :								
Bombay Centre	7	7	7	4	6	1	...	...
Ahmedabad Centre ...	10(b)	14	14	4	14	7	...	...
Other Centres...	40(c)	44	42	42	42	5	...	1(d)
Total Cotton Mill.	57(e)	65	63	50	62	13	...	1
Iron & Steel ...	2(f)	3	3	1	3	...	...	...
Engineering & Construction ...	9(g)	13	13	10	13	...	...	...

(a) Two companies, *viz.*, Clive Mills, Ltd., and Naihati Jute Mills Co., Ltd., have two issues of preference shares each.

(b) Two companies *viz.*, the Calico Printing and Manufacturing Co., Ltd., and the Shree Ambica Mills, Ltd., have two preference share issues each. The Ajit Mills, Ltd., has three preference share issues.

(c) Four concerns, *viz.*, the Bowreah Cotton Mills Co., Ltd., the Vasanta Mills, Ltd., the Elgin Mills Co., Ltd., and the Gopal Mills Co., Ltd., have two issues of preference shares each

(d) The preference shares, of the company concerned, *viz.*, Kesoram Cotton Mills, Ltd., carry in a winding up preferential claim to one-fourth of the balance of the assets available.

(e) See (c) and (d).

(f) One company, *viz.*,the Tata Iron and Steel Co., Ltd., has two issues of preference shares.

(g) Two companies, *viz.* Burn and Co., Ltd., and MacKenzies, Ltd., have two preference share issues each, while the Premier Construction Co., Ltd., has three preference share issues.

DISTRIBUTION OF PREFERENCE SHARE ISSUES OF COMPANIES ACCORDING TO RIGHTS AND PRIVILEGES.-(contd.)

Name of Industry	No. of cos. issuing	No. of issues	Cumulative	Tax free	Preferential claim to Repayment of Capital in winding up	Redeemable	Participating in profits	Participating in Surplus Assets in winding up
Coal	9	9	8	9	8	1	1	...
Electric	27(h)	30	28	21	29	...	3	2(i)
Tea	23	23	20	23	21	6	3	1(j)
Cement	2	2	2	2	2	1	1	...
Sugar	23(k)	28	28	25	27	8	5	...
Chemical... ...	5(l)	6	6	5	5	1	...	1(m)
Paper	5(n)	7	7	7	7	3	1	...
Steamship ...	2	2	2	1	2	...	...	...
Timber	1	1	1	1	1	...	...	1(o)
Total	215	240	234	205	228	39	17	6

(h) Three companies, *viz.*, the Lahore Electric Supply Co., Ltd., the South Madras Electric Corporation Ltd., and the Guntur Electric Supply Co., Ltd., have two issues of preference shares each.

(i) The two issues of preference shares of the Lahore Electric Supply Co., Ltd., are entitled to one-fifth of the surplus assets available after repayment of capital on both the preference and ordinary shares.

(j) The preferred ordinary shares of the Murphulani (Assam) Tea Co., Ltd., participate rateably with the ordinary shares in the residue, if any, of such surplus assets as shall remain after paying off the ordinary capital of the company.

(k) Two companies, *viz.*, the Gwalior Sugar Co., Ltd., and the Shree Krishna Gyanoday Sugar Ltd., have two issues of preference shares each. The New India Sugar Mills, Ltd., has three preference share issues.

(l) One company, *viz.*, the Alembic Chemical Works, Ltd., has two issues of preference shares.

(m) The preference shares of the Bengal Chemical & Pharmaceutical Works, Ltd., in a winding up rank *pari passu* with the ordinary shares as regards distribution of assets of the company.

(n) Two companies, *viz.*, Bengal Paper Mills Co., Ltd., and the Titaghur Paper Mills Co., Ltd., have two preference share issues each.

(o) The preference shares of the Bengal Timber Trading Co., Ltd., are entitled to preferential repayment of capital together with a premium of Rs. 30 per share.

A glance at the table will show that there are three main rights or privileges which are common to the majority of preference share issues in this country, *viz.*, (1) the right to receive a cumulative dividend, (2) the right to payment of the preference dividend free of income-tax, and (3) the right to repayment of capital in a winding up. The first important division of preference shares is into cumulative and non-cumulative. In the case of the former type, the preference dividend if not paid in any one year will be carried over to the next, and unless the accumulated preference dividends are paid off no dividends will be declared on the ordinary shares. It will be seen from the table that 234 of the 240 issues of preference shares are cumulative. The only explanation that can be offered as regards the popularity of the cumulative feature in this country is that it is only by the incorporation of this provision that preference shares are made more attractive to the investors. As the non-cumulative preference shares carry a certain elementary risk they do not attract the conservative type of investors. Another fact adding to the attractiveness of the preference shares is their exemption from the payment of income-tax. In these days of high taxation, preference shares with even a low rate of interest but free of income-tax, would be preferable to those with a higher rate of interest but subject to taxation. It will be seen from the table that out of the 240 issues of preference shares as many as 205 are free of income-tax. The right to preferential claim to repayment of capital in a winding up is rather common with preference shares issues in this country. It will be observed from

the table that as many as 228 out of the 240 issues of preference shares carry preferential right to repayment of capital in a winding up. If the preference shares are entitled to a preferential claim for the payment of a dividend out of the profits before any dividend is declared on the ordinary shares, then naturally it would follow that in a winding up they would be entitled to a prior claim on the assets for the repayment of capital. Any surplus would then be shared by the ordinary and deferred shareholders.

A detailed examination of the preference share issues of the different industries with regard to the three important rights and privileges pointed out above would be interesting. As regards the cumulative feature, it will be observed that all the issues of preference shares of the jute, cotton mill at Bombay and Ahmedabad centres, iron and steel, engineering, cement, sugar, chemical, paper, steamship and timber industries are cumulative. As regards taxation all the preference issues of the coal, tea, cement, paper and timber industries are tax free. As regards preferential claim to repayment of capital, all the issues of the cotton mill industry at Ahmedabad centre, the iron and steel, engineering, cement, paper, steamship and timber industries carry this right.

Preference shares with other rights besides those noted above, can also be issued. For example, preference shares can be issued with the right to participate in the profits of the company over and above the fixed dividend to which they are entitled. The right to share in the profits in the case of these participating

preference shares can be arranged in many ways. For instance, after the payment of a fixed dividend of, say 5%, has been paid on the preference shares and the ordinary shares have been provided with a similar dividend, the preference share may carry the right to participate in a further dividend of half or one per cent, as the case may be, rateably with the ordinary shares up to a certain specified maximum, say 9 or 10%.* In some other cases it is arranged that after the preference shares get their fixed dividend, *e.g.* 6% and after a similar dividend has been paid on the ordinary shares, one-fifth of the divisible profits would go to the preference shareholders and four-fifths to the ordinary.† A rather uncommon arrangement is where after the payment of a fixed dividend has been paid on the ordinary shares, the surplus profits would be distributed amongst the holders of the preference and ordinary shares *pari passu* as one class of shares.‡ It will be seen from the table that in India preference shares with the right to participate in the profits of the company are not much common. Indeed, out of the 240 preference issues only 17 carry the right to participate in the profits.

Preference shares with another feature, *viz.*, callability or redeemability can also be issued and are quite common in the U.S.A. This type of preference shares has many advantages to offer. For example,

*See, for example, the rights of the participating preference shares of: Craig Jute Mills, Ltd., Waverly Jute Mills Co., Ltd., and New India Sugar Mills Ltd.

†For example, in the case of the Lahore Electric Supply Co., Ltd. In the case of Shree Gopal Paper Mills, Ltd., after the payment of 6% on the preference shares, and after the ordinary shares have been provided with a dividend of 10%, the preference shares carry the right to participate in the profits to the extent of 25%, but the total dividend on these shares should not exceed 8%.

‡For example, in the case of the Indian Cable Co., Ltd.

in the case of a company which has been newly started and its credit not well established, an issue of redeemable preference shares is advantageous. For, later on when the company is well established, ordinary shares can be substituted for the preference shares, and the financial position of the company can be placed on a better footing. In some cases it is found that due to market conditions preference shares have to be issued at a high rate of interest. In such cases, if the preference shares are made redeemable they can later on be substituted by an issue of preference shares at a lower rate of interest. A new concern can with advantage issue redeemable preference shares in order to secure working capital or to meet some other current expenses, with the intention later on to redeem the issue with the reserves created out of profits. In such cases, the issue serves a double purpose : it helps the company to raise capital without affecting its control on the one hand, and without incurring fixed obligations on the other.* As compared with debentures whose date of maturity is fixed, the date of redemption of redeemable preference shares is not fixed in many cases. The only provision to be found is that the necessary notice, *viz.*, 3 or 6 months, as the case may be, must be given. In most cases it is provided that the redeemable preference shares shall be redeemed at a premium which is from 10 to 25% above the par value of the shares.

The advantage of the issue of redeemable preference shares becomes obvious in India because

*See D. R. Samant and M. A. Mulky : Organization and Finance of Industries in India, 1937, p. 84.

of the fact that industrial concerns meet with financial difficulties at their very inception due to faulty financial calculation. In such cases, the concerns can obtain the necessary capital for current expenses or working capital by the issue of redeemable preference shares, and escape from the difficulties which borrowing from outside sources entails, *e.g.*, from banks at high rates of interest, or by the issue of debentures involving the payment of permanent fixed interest charges. But the importance of this type of preference shares does not seem to have been fully understood by industrial concerns in this country, in spite of the fact that under the amendment to the Indian Companies Act in 1936, *viz.*, the addition of a new section 105B provision, has been made for the issue of redeemable preference shares. Out of the 240 issues of preference shares (see table), only 39 issues carry the right of redeemability; the jute industry having 6 redeemable preference share issues, the cotton mill 13, sugar 8, tea 6, paper 3, the coal, cement and chemical industries 1 each.

Reference may be made to another right which has been incorporated by a recent flotation, *viz.*, the New India Sugar Mills Ltd., in its issue of preference shares, besides redeemability. This is the right of convertibility of the preference shares into ordinary shares. The convertible redeemable preference shares which were issued by the company in 1939 carry the right to a fixed cumulative preferential dividend of $7\frac{1}{2}\%$ (tax free), and, at the option of the holders, they may at any time be converted into ordinary shares at par. The company may at any time after

1944 redeem these shares at par, by giving one calendar month's notice.*

Lastly, it may be pointed out that preference shares can be issued with one more right, *viz.*, preferential claim to participate in the surplus assets in a winding up. This claim is in addition to the preferential right to repayment of capital to which we have already referred. Preference share issues with this right are not common in this country. Out of the 240 preference share issues (see table) only 6 issues (issued by 5 concerns—one company having 2 issues) carry preferential claim to participate in the surplus assets in a winding up. Actually only 4 out of these 6 issues carry both the rights to full repayment of capital and participation in the division of the surplus assets. As regards the first 4 issues, in the case of the two issues of the Lahore Electric Supply Co., Ltd., in a winding up the surplus assets available shall be applied, first, in repayment of capital on the preference shares, secondly, in repayment of capital on the ordinary shares, and, thirdly, the balance shall belong as to one-fifth to the holders of the preference shares and the remaining four-fifths to the holders of the ordinary shares. The preference shares of the Bengal Timber Co., Ltd., in a winding up are entitled to preferential repayment of capital together with a premium of Rs. 30 per share. In the case of the Murphulani (Assam) Tea Co., Ltd., the preferred ordinary shares besides carrying preferential claim to repayment of capital participate rateably with the ordinary shares in the

*See Investors India Year-Book 1944-45, (Place, Siddons and Gough, Calcutta), p. 165.

residue, if any, of such surplus assets as shall remain after paying off the ordinary capital of the company. In the case of the remaining two issues, *viz.*, those of the Kesoram Cotton Mills, Ltd., and the Bengal Chemical and Pharmaceutical Works, Ltd., it is not clear whether the preference shares in a winding up are entitled to full repayment of capital before being entitled to participate in the surplus assets. The preference shares of the Kesoram Cotton Mills, Ltd., in a winding up carry preferential claim to the cumulative dividend and to one-fourth of the balance of assets available, the ordinary receiving the remaining three-fourths. In the case of the Bengal Chemical & Pharmaceutical Works, Ltd., in a winding up the preference shares rank *pari passu* with the ordinary shares as regards distribution of the assets of the company.

We now come to deferred shares. In discussing the rights and privileges of ordinary shares reference was made to the rights of deferred shares also. These shares otherwise known also as founders' shares are usually given to the original promoters or vendors of the new venture by way of reward for their services of promotion or otherwise. These shares participate in the profits of a company after a specified rate of dividend is paid on the preference and ordinary shares. We have already described the various ways by which the profits and assets of a company are distributed as between the ordinary and deferred shareholders. The deferred shares represent a small amount of capital as compared with the ordinary shares and when a company makes large profits the share of deferred shareholders in the shape of dividends becomes larger. As a result of this

factor these shares offer great scope for speculation. We need only point out here to the deferred shares of the Tata Iron and Steel Co., Ltd., whose nominal value is only Rs. 30 per share, but which were quoted at as high as Rs. 2,350. The advantages of an issue of deferred shares are few, and as far as possible their issue should be discouraged.

And lastly we come to debentures. Until recently industrial concerns in this country did not favour an issue of debentures. In the first place, industrial concerns have felt that as debentures are secured against their assets, this might affect their credit and make borrowing difficult. Banks, for example, have been known to be reluctant to advance to industrial concerns which have debenture issues. Secondly, industrial concerns have felt that the cost of making a debenture issue has been rather high, in this country; the underwriting charges have been high, and besides, the high stamp duty had to be reckoned with. Debentures have also not been popular with Indian investors as a form of investment, the reason being that there is a class of investors in this country whose policy is to look to capital appreciation on their investments and debenture loans with a fixed rate of interest and offering little chances of capital appreciation have therefore no attraction for them.*

The debenture holders of a company are its creditors unlike the shareholders who occupy the position of actual proprietors. The question of the transfer of ownership from the shareholders to the

* See Indian Central Banking Enquiry Committee (Majority) Report, Vol. I., p. 274.

debenture holders arises only in the event of the default of payment on the debentures on due dates, or the failure to redeem them at maturity. In recent years it has been found that quite a large number of industrial concerns in this country have resorted to debenture issues for raising their capital. With a view to make this type of security more attractive to the investors, many companies have incorporated certain rights in their debenture issues, *e.g.*, the right of convertibility, under which the debenture holder is given option after a certain time to convert his holdings into ordinary shares at a fixed ratio.

Denomination of the Different Types of Security.

Reference may now be made to a subject which has not received much attention in India, *viz.*, the denomination of the different types of security. It will be recognised that the denomination of the different types of security must be kept a figure which would appeal to the particular type of investor approached. For example, take the preference share with its fixed yield. This type of security would appeal to the small investor ; the advantage of keeping the denomination of preference shares low in order to attract the savings of this type of investors becomes obvious. A study of the different types of security in India with regard to their denomination will show the lack of any uniformity. Take for example the ordinary shares. The following table will give an idea of the variety of denomination of the ordinary share issues of 597 industrial companies :—

DISTRIBUTION OF ORDINARY SHARE ISSUES OF COMPANIES : ACCORDING TO DENOMINATION.

Name of Industry	No. of cos.	No. of issues	RUPEES. ½	1	2	2/8	3	3/8	5	6	7	7/8	8	10	15	20	25	30	40	50	60	75	100	125	200	250	300	375	500	1,000	2,500
Jute	61	61	1	1					1			1		19			1		1	1			32				2	1			
Cotton Mill: Bombay Centre	44 (a)	48			1									4		1	1			3			23		2	5			4	4	
Ahmedabad Centre	28	28																		1			17	2		3				5	
Other Centres	95 (b)	97				4								25	1	1	3		2	10	1		40		1	4			2	3	
Total Cotton Mill	167 (c)	173			1	4								29	1	2	4		2	14	1		80	2	3	12			6	12	
Iron and Steel	5	5												4								1									
Engineering & Construction	25	25			2		1	1	1		1			12			1	1		2			3								
Coal	55	55		1		4	1		2				1	45									1								
Electric	70 (d)	71										1	1	40		1	2		1	4			18							3	
Tea	133 (e)	134							5	1				87		1	1			1			38								
Cement	4	4							1					2									1								
Sugar	49 (f)	51										1		34			2			1			13								
Chemical	7	7												5									2								
Paper	8 (g)	10				1			2					4			1						2								
Steamship	6	6												2	1								2			1					1
Timber	4 (h)	5		1										1									1	1							
Match	2	2												1									1								
Radio and Cable	1	1																					1								
Total	597	610	1	3	3	9	2	1	12	1	1	3	2	285	2	4	12	1	4	23	1	1	195	3	3	13	2	1	6	15	1

(a) Four companies, *viz.*, David Mills Co., Ltd., the Hindustan Spinning and Weaving Co., Ltd., the Indian Bleaching Co., Ltd., and the Madhusudan Mills, Ltd., have two issues of ordinary shares each of different denominations.

(b) Two companies *viz.*, Khandesh Mills Co., Ltd., and the Delhi Cloth & General Mills Co., Ltd., have two issues of ordinary shares each of different denominations.

(c) See (*a*) and (*b*).

(d) One company, *viz.*, the Lahore Electric Supply Co., Ltd., has two issues of ordinary shares of different denominations.

(e) One company, *viz.*, Grob Tea Co., Ltd., has two issues of ordinary shares of different denominations.

(f) Two companies, *viz.*, the Deccan Sugar and Abkhari Co., Ltd., and the Upper India Sugar Mills, Ltd., have two ordinary share issues each of different denominations.

(g) One company, *viz.*, the Titaghur Paper Mills Co., Ltd., has two issues of ordinary shares each of different denominations (the second issue being again subdivided into "A" and "B" but with the same denomination).

(h) One company, *viz.*, the Bombay Burma Trading Corporation Ltd., has two issues of ordinary shares of different denominations.

The table will show the variety of denomination of ordinary share issues ranging from annas 8 to Rs. 2,500. Closer examination of the table with reference to particular industries would give interesting results. For example, in the case of the jute industry, Rs. 10 and Rs. 100 ordinary shares seem to be much favoured, —as many as 19 ordinary share issues out of the 61 being of Rs. 10 each, and 32, *i.e.* nearly half, being of Rs. 100 each. There is the rather exceptional instance of the issue of an 8 annas share by one company. Two issues of ordinary shares are of Rs. 300 each, while one issue is of Rs. 375. The cotton mill industry seems to have favoured the Rs. 100 shares. This can be seen from the fact that at Bombay centre, out of 48 issues of ordinary shares, 23 or nearly half are of Rs. 100 each, while at the Ahmedabad centre out of 28 issues 17 or more than half are of Rs. 100 each. In the other centres, out of 97 issues of ordinary shares, 40 are of Rs. 100 each. The Rs. 10 share both in Bombay and Ahmedabad does not seem to have been at all favoured,-in the former centre only 4 issues are of that denomination. At the other cotton mill centres, 25 out of the 97 ordinary share issues are of Rs. 10. It may be interesting to note some other features regarding the cotton mill industry, *viz.*, that there are ordinary shares of the denomination of as low as Rs. 2, while there are shares of as high a denomination as Rs. 500 and even Rs. 1,000. Besides, it may be noted that in the case of the 48 ordinary share issues of the Bombay cotton mill companies as many as 15 issues have higher than Rs. 100 denomination, and at the Ahmedabad centre, 10 out of 28 issues have higher than Rs. 100 denomination. For the cotton mill industry as a whole it will be seen that

the Rs. 100 ordinary share is much more favoured than shares of other denominations.

The Rs. 10 ordinary share seems to be more favoured in the coal industry, where as many as 45 out of 55 issues are of this denomination. So also in the iron and steel industry, where 4 out of the 5 issues are of Rs. 10. The Rs. 10 denomination is also popular with the engineering and construction industries, as well as the tea, electrical, sugar, chemical and cement industries. It will be seen that in each group of these industries nearly half or more the ordinary share issues are of Rs. 10. The next popular denomination favoured by most of these industries is the Rs. 100 share. It may be noted that one company, *viz.*, the Bombay, Burma Trading Co., Ltd., has a very high denomination for its ordinary share issue, *viz.*, of Rs. 2,500.

For the 610 ordinary share issues as a whole it will be seen that the Rs. 10 and Rs. 100 shares are the most popular, there being as many as 285 issues of Rs. 10 and 195 of Rs. 100. It may be interesting to note that the companies whose shares are quoted on the Calcutta Stock Exchange seem to have favoured the Rs. 10 denomination ordinary share, the Rs. 100 share being the next favourite. This can be seen from an examination of the ordinary share issues of the jute, coal, tea, paper and sugar industries, whose shares are quoted mainly on the Calcutta Stock Exchange. On the other hand, on the Bombay Stock Exchange, the Rs. 100 share seems to be more favoured as a reference to the issues of the cotton mill companies will show.

The variety of the denomination of preference share issues will become evident from the following table :—

DISTRIBUTION OF PREFERENCE SHARE ISSUES OF COMPANIES : ACCORDING TO DENOMINATION.

Name of Industry.	No. of co's.	No. of issues.	RUPEES.														
			3	5	10	15	20	25	50	100	125	150	200	250	300	500	1,000
Jute	49 (a)	51			2				2	46					1		
Cotton Mill:																	
Bombay Centre	7	7						1		4			1	1			
Ahmedabad Centre	10 (b)	14							1	11	1			1			
Other Centres	40 (c)	44		1	9	1	1	1	3	25				1		2	
Total Cotton Mill	57 (d)	65		1	9	1	1	2	4	40	1		1	3		2	
Iron & Steel	2 (e)	3								2		1					
Engineering & Construction ...	10 (f)	13			2					11							
Coal	9	9			2				1	6							
Electric	27 (g)	30			9			1	1	17							2
Tea	23	23	1		6					16							
Cement	2	2			1					1							
Sugar	23 (h)	28			3				1	24							
Chemical	5 (i)	6			2					4							
Paper	5 (j)	7							1	6							
Steamship	2	2								1				1			
Timber	1	1								1							
Total ...	215	240	1	1	37	1	1	3	10	175	1	1	1	3	1	2	2

(a) Two companies, *viz.*, Clive Jute Mills Ltd., and Naihati Jute Mills Co., Ltd., have two preference share issues each.
(b) Two companies, *viz.*, Calico Printing and Manufacturing Co., Ltd., and the Shri Ambica Mills, Ltd., have two issues of preference shares each. The Ajit Mills Ltd., has three preference share issues.
(c) Four companies, *viz.*, Bowreah Cotton Co., Ltd., Vasanta Mills, Ltd., Elgin Mills Co., Ltd., and Gopal Mills Co., Ltd., have two issues of preference shares each.
(d) See (b) and (c).
(e) One company, *viz.*, the Tata Iron & Steel Co., Ltd., has two preference share issues.
(f) Two companies, *viz.*, Burn & Co., Ltd., and Mackenzies, Ltd., have two issues of preference shares, while the Premier Construction Co., Ltd., has three preference share issues.
(g) Three companies, *viz.*, Lahore Electric Supply Co., Ltd., South Madras Electric Corporation, Ltd., and Guntur Electric Supply Co., Ltd., have three issues of preference shares each.
(h) Two companies, *viz.*, the Gwalior Sugar Co., Ltd., and the Shree Krishna Gyanoday Sugar, Ltd., have two issues of preference shares each. The New India Sugar Mills, Ltd., has three preference share issues.
(i) One company, *viz.*, Alembic Chemical Works, Ltd., has two issues of preference shares.
(j) Two companies, *viz.*, Bengal Paper Mills Co., Ltd., and the Titaghur Paper Co., Ltd., have two preference issues,

It will be seen from the table that the denominations of the preference shares issued by the 215 industrial companies range from Rs. 3 to Rs. 1,000. As many as 175 issues of preference shares have denomination of Rs. 100, 37 issues have denomination of Rs. 50. It will be seen that the Rs. 100 denomination in the case of preference shares is rather common and some sort of uniformity in this regard seems to have been achieved by the industrial companies. We have pointed out in the case of ordinary shares that the Rs. 10 denomination is more favoured by companies whose securities are quoted on the Calcutta Stock Exchange. Similarly, in the case of the preference shares of companies quoted on that Exchange, the Rs. 100 denomination seems to be much popular. Another noticeable feature on that side is the uniformity practised by companies in fixing the denomination of ordinary and preference shares (in the case of companies having both ordinary and preference share issues) at Rs. 10 and Rs. 100 respectively. Recent Bombay flotations have followed this practice.

The following table will give an idea of the denomination of deferred share issues of 18 companies :—

DISTRIBUTION OF DEFERRED SHARE ISSUES OF COMPANIES : ACCORDING TO DENOMINATION.

Name of Industry.	No. of cos. issuing.	RUPEES.						
		1	2/8	3/12	5	10	30	100
Jute ...	1	1						
Cotton Mill:								
Bombay Centre ...	3	2			1			
Ahmedabad Centre ...	1	1						
Other Centres ...	5	4				1		
Total Cotton Mill ...	9	7			1	1		
Iron & Steel ...	2		1				1	
Engineering & Construction ...	2	1		1				
Cement ...	1	1						
Sugar ...	1		1					
Chemical ...	1	1						
Radio & Cable ...	1							1
Total	18	11	2	1	1	1	1	1

It will be seen from the table that 11 out of the 18 deferred share issues are of Re. 1 denomination. It will be noticeable that the small denomination is favoured ; actually, there is only one deferred share issue of Rs. 100 denomination. The small denomination is favoured for the reason that by giving the deferred share equal voting rights with the ordinary and preference shares, it is possible to keep control over a company even with a relatively small holding.*

The debenture with its fixed yield and the security behind it would have a better appeal to the conserva-

*See D. R. Samant and M. A. Mulky : Organization and Finance of Industries in India, 1937, p. 84.

tive type of investors than the preference share. If, therefore, the denomination of this type of security is kept low, it would be within the reach of the small investor. The following table will give an idea of the denomination of the debenture issues of 91 industrial companies in India :—

DISTRIBUTION OF DEBENTURE ISSUES OF COMPANIES : ACCORDING TO DENOMINATION.

Name of Industry	No. of cos. issuing.	No. of issues	RUPEES. 100	250	500	1,000	5,000	50,000
Jute	22(a)	24			14	9	1	
Cotton Mill :								
Bombay Centre ...	2	2		1	1			
Ahmedabad Centre ...	1	1				1		
Other Centres... ...	12	12	2	1	4	4	1	
Total Cotton Mill ...	15	15	2	2	5	5	1	
Engineering and Construction ...	3	3			3			
Coal	3(b)	4	1		1	2		
Electric	13	13	4		4	4		1
Tea	5	5	2		1	1	1	
Cement	2	2			2			
Sugar	19(c)	21			14	7		
Chemical	2	2	2					
Paper	5	5			2	3		
Steamship	1	1				1		
Timber	1	1			1			
Total	91	96	11	2	47	32	3	1

(a) Two companies, viz., the Calcutta Jute Manufacturing Co., Ltd., and the Hukumchand Jute Mills, Ltd., have two issues of debentures each.
(b) One company, viz., the Oriental Coal Co., Ltd., has two issues of debentures.
(c) One company, viz., Ramnugger Cane and Sugar Co., Ltd., has three debenture issues.

It will be seen from the table that the denomination of debentures ranges from Rs. 100 to Rs. 50,000. The Rs. 500 and Rs. 1,000 denominations seem to be popular, as many as 47 out of the 96 issues having the former denomination and 32 having the latter. The issues with the Rs. 100 denomination number 11.

Some sort of uniformity of denomination for the three types of securities, *viz.*, ordinary shares, preference shares, and debentures is highly desirable. In the case of ordinary shares we have seen that the Rs. 10 and Rs. 100 denominations are much favoured; while in the case of preference shares the Rs. 100 denomination seems to be more popular. Both the Rs. 10 and Rs. 100 denominations are within the reach of the small Indian investor, but the Rs. 500 and Rs. 1,000 denominations which have been favoured for debentures are definitely outside his reach. It is, therefore, desirable that the denomination for debentures should be fixed at Rs. 100 so as to enable the small investor to invest in this safe type of security. If ordinary shares of Rs. 10 each, preference shares of Rs. 100 each, and debentures also of Rs. 100 each are issued by companies, some uniformity of denomination will be easily obtained.

CHAPTER V.

THE PRICE OF NEW INDUSTRIAL CAPITAL.

One of the important problems of industrial finance in India is the price of new capital. It is well known in this country that the name and reputation of the managing agency firm behind a few industrial venture has much to do with its successful flotation and the raising of its capital on favourable terms. It will be interesting to make a study of the price paid by industrial concerns in the raising of their capital, as this subject has not so far attracted any attention.

The price of new capital consists of two items, *viz.*, (1) the rate of interest which a company has to pay to the lenders, and (2) the cost of making the issue.* As regards the former, a company can avoid payment of interest charges on its capital raised by the issue of preference shares or debentures by the issue of only ordinary shares. But this is not always feasible ; preference shares and debentures have to be issued to attract capital from a type of investors who prefer to invest only in fixed interest yielding securities. The ordinary shareholders of a company are its proprietors, and, therefore, share in the profits of the venture. It is not necessary to state in the Prospectus of a new company inviting subscriptions from the public the rate of dividend that will be declared on the ordinary capital. But it is usual to find in Prospectuses statements made by the promoters to the effect that the expected earnings of the venture will be such as to enable the declaration of a specified rate of dividend

* See A. T. K. Grant : A Study of the Capital Market in Post-War Britain, 1937, p. 167

on the ordinary shares. The rate of dividends to be expected will be higher in the case of untried and new undertakings. For example, in this country, in order to raise the capital of a new cotton mill by the issue of ordinary shares the investors have to be offered a return of 5 to 6 per cent. The cotton mill industry has now been well established for a long time in this country, and hence it is possible to attract investors at this rate. But in the case of new ventures out of the beaten track, a return of as much as 10 to 15 per cent has to be assured to the ordinary shareholders.

Rate of Interest Paid on Preference Shares and Debentures.

While the debenture holders are the creditors of the company, the preference shareholders jointly with the ordinary shareholders are the proprietors of the undertaking. Yet, in view of the fixed rate of interest that has to be paid to the preference shareholders, they become lenders of capital to the company as it were. In this Chapter we are concerned with the rate of interest paid by industrial concerns in this country to raise new capital by the issue of preference shares and debentures. The rate of interest that a company has to pay on its preference shares or debentures will depend on several factors, *e.g.*, the probable success of the venture and the standing and reputation of the firm of managing agents in charge of its management, the time of making the issue, etc.

The following table will give an idea of the rate of interest paid on preference share issues of 205 industrial companies :—

DISTRIBUTION OF PREFERENCE SHARE ISSUES ACCORDING TO RATE OF INTEREST.

Industry	No. of cos. issuing	No. of issues	RATE OF INTEREST										
			3	4	4½	5	5¼—5½	6	6¼—6½	7	7¼—7½	8	10
Jute ...	49 (a)	51			1	2	1	11	1	31	2	1	1
Cotton Mill:													
Bombay Centre ...	7	7		2		2		1		2			
Ahmedabad Centre ...	10 (b)	14		1	3	7	2	1					
Other Centres ...	40 (c)	44	1		2	4		13	9	9	3	3	
Total Cotton Mill ...	57 (d)	65	1	3	5	13	2	15	9	11	3	3	
Iron & Steel ...	2 (e)	3				1		1			1		
Engineering & Construction	10 (f)	13			1	3	2	1	2	4			
Coal ...	9 (g)	11						4	1	5		1	
Electric ...	27 (h)	30				2	5	8	9	5	1		
Tea ...	23	23				2		5		6		9	1
Cement ...	2	2						2					
Sugar ...	23 (i)	28				6	3	7	1	5	4	1	1
Chemical ...	5 (j)	6				3		1	1		1		
Paper ...	5 (k)	7				2	1	1		2		1	
Steamship ...	2	2								1			
Timber ...	1	1										1	
Total	205	242	1	3	7	34	14	57	24	70	12	17	3

(a) Two companies, *viz.*, Clive Jute Mills, Ltd., and Naihati Jute Mills Co., Ltd., have two issues of preference shares at different rates of interest.

(b) One company, *viz.*, the Ajit Mills, Ltd., has three preference share issues at different rates of interest while two companies, *viz.*, the Calico Printing and Manufacturing Co., Ltd., and Shri Ambica Mills, Ltd., have two issues each at different interest rates.

(c) Four companies, *viz.*, the Bowreah Cotton Mills, Ltd., the Elgin Mills Co., Ltd., the Gopal Mills Co., Ltd., and the Vasanta Cotton Mills, Ltd., have two issues of preference shares each at different interest rates.

(d) See (*b*) and (*c*).

(e) The Tata Iron & Steel Co., Ltd., has two preference share issues at different rates of interest.

(f) Burn & Co., Ltd., has two preference issues at different rates, while MacKenzies, Ltd., has two issues at the same rate. The Premier Construction Co., Ltd., has two issues of preference shares at the same interest rate and a third issue at a different rate.

(g) The Oriental Coal Co., Ltd., has two preference share issues at different rates of interest.

(h) Three companies, *viz.*, the Lahore Electric Supply Co., Ltd., the South Madras Electric Supply Co., Ltd., and the Guntur Electric Supply Co., Ltd., have two issues of preference shares each at different rates.

(i) Two companies, *viz.*, the Shree Krishna Gyanoday, Sugar Ltd., and the Gaya Sugar Mills, Ltd., have two preference share issues at different interest rates, while the Gwalior Sugar Co., Ltd., has two issues at the same rate. The New India Sugar Mills, Ltd., has three preference share issues two of which bear the same rate of interest.

(j) The Alembic Chemical Works, Ltd., has two preference share issues at different rates.

(k) The Bengal Paper Mills Co., Ltd., has two issues of preference shares at the same rate of interest, while the Titaghur Paper Mills Co., Ltd., has two issues at different rates.

It will be seen from the table that the rate of interest at which preference shares have been issued varies from 3 per cent to 10 per cent. The average rate of interest on the 242 issues of preference shares comes to a little over 6.1 per cent, which is a fairly high rate of interest for preference share issues. Detailed examination of the table by industries will reveal interesting facts in regard to the rate of interest paid by each particular industry on preference share issues. In spite of the fact that the jute industry has been under the control of managing agency firms of high repute and standing, the jute mills have not been able to raise preference capital at advantageous rates. More than half of the issues, *viz.*, 31 out of 51, have been made at 7 per cent., 11 at 6 per cent, 1 at the high rate of 8 per cent, while one bears the very high rate of 10 per cent. Only three issues have been made at and under 5 per cent.

Leaving aside the Bombay and Ahmedabad centres of the cotton textile industry where preference shares are not popular, it will be seen that at other centres of this industry preference capital has been raised at high rates. Out of 44 issues only 7 have been made at or under 5 per cent interest. As many as 13 bear 6 per cent interest, while 18 bear between 6¼ and 7 per cent, and 6 between 7¼ and 8 per cent. In the iron and steel industry, while one concern, *viz.*, the Steel Corporation of Bengal, Ltd., has been able to raise its preference capital at 5 per cent, the other, *viz.*, the Tata Iron and Steel Co., Ltd., has raised its two issues of preference capital at the rather high rates of 6 and 7½ per cent. No doubt, the explanation for the issue

of the preference shares of the Tata Steel Co., at high interest rates will be found in the fact that the company was floated in the early years of the present century when capital was shy and the investors could be coaxed only by the payment of high interest rates. The Steel Corporation of Bengal was promoted only a few years back, that is, at a time when the steel industry in India was already established owing to the pioneering efforts of the Tata Steel Co. The engineering industry is another industry that has also issued its preference shares at fairly high rates. In the coal industry all the 11 issues bear interest at 6 per cent and over; six issues bearing 7 per cent and over interest. More or less similar conditions prevail in the electric industry, where out of 30 issues only 7 carry less than 6 per cent interest. In the tea industry only 2 out of the 23 issues carry less than 6 per cent interest, while out of the 21 issues carrying interest at 6 per cent and over as many 9 carry 8 per cent interest, one carrying the high rate of 10 per cent. The preference issues of the cement, steamship and timber industries all carry interest at 6 per cent and over. In the sugar industry 19 out of 28 preference issues bear 6 per cent and over interest; one issue bears 8 per cent and one the high rate of 10 per cent. In the chemical industry out of the 6 preference issues, 3 have been made at 6 per cent and above, while in the paper industry out of the 7 issues 3 carry over 6 per cent interest—one issue bearing 8 per cent. It will be noticed that out of the 242 preference share issues, more than half, *viz.*, 126 carry over 6 per cent interest.

As regards the rate of interest paid on debentures the following table will give an idea of the rate of interest paid on debenture issues of 99 industrial companies.

DISTRIBUTION OF DEBENTURE ISSUES ACCORDING TO RATE OF INTEREST.

Industry	No. of cos. issuing	No. of issues	RATE OF INTEREST											
			2½	3	3¼–3¾	4	4¼–4¾	5	5½–5¾	6	6¼–6¾	7	7½	8
Jute	21(a)	23			1	3	11		1	3		4		
Cotton Mill :														
Bombay Centre	2	2						1		1				
Ahmedabad Centre	1	1						1						
Other Centres	12	12		1			2	2	2	3	1		1	
Total Cotton Mill	15	15		1			2	4	2	4	1		1	
Iron and Steel	2	2				1(b)	1(c)							
Engineering and Construction ...	3	3						2		1				
Coal	3(d)	4								2		2		
Electric	18	18				2	3	7	3	2	1			
Tea	5	5						1	1	1		2		
Cement	2	2				1			1					
Sugar	21(e)	23	1			1	2	7	2	3	2	3	1	1
Chemical	2	2				1	1							
Paper	5(f)	6					2	2		2				
Steamship	1	1		1										
Timber	1	1						1						
Total	99	105	1	2	1	9	22	24	10	18	4	11	2	1

(a) One company, *viz.*, Hukumchand Jute Mills, Ltd., has 3 debentures issues at different rates of interest.
(b) Debentures raised in London by the Indian Iron and Steel Co., Ltd.
(c) Debentures raised in London by the Steel Corporation of Bengal, Ltd.
(d) One company, *viz.*, Oriental Coal Co., Ltd., has two issues at different rates.
(e) One company, *viz.*, the Ramnugger Cane and Sugar Co., Ltd., has three issues of debentures at different interest rates.
(f) One company, *viz.*, Shree Gopal Paper Mills, Ltd., has two debenture issues at the same interest rate.

It will be seen from the table that the rate of interest paid on debentures varies from $2\frac{1}{2}$ per cent to 8 per cent. The average rate of interest paid on the 105 issues of debentures is 5.5 per cent which compares favourably with the average rate of interest paid by industrial companies on their preference shares, *viz.*, 6.2 per cent. This is rather interesting as until recent years debentures were looked upon with disfavour by Indian investors, and consequently industries experienced difficulties in issuing them except at high rates.

The table will also show that more than half of the 105 issues of debentures, *viz.*, 59 bear 5 per cent and less interest. If we turn to individual industries, we find that whereas certain industries have been able to issue debentures at favourable rates others have not been able to do so. In the electric industry out of 18 debenture issues, 12 bear between 4 and 5 per cent interest,—rather favourable terms. The sugar industry has, however, not been so fortunate, for out of the 23 issues 10 bear between 6 and 8 per cent interest. The jute industry's preference issues bear fairly high rates of interest, but the industry has been more fortunate in the raising of its debentures, for out of 23 issues as many as 15 carry between $3\frac{1}{4}$ and $4\frac{3}{4}$ per cent interest. The iron and steel, engineering, cement, chemical, steamship, paper and timber industries have also issued their debentures at and under 6 per cent interest, but the coal and tea industries have not been so fortunate.

TREND OF LONG TERM INTEREST RATE.

Having seen the rates of interest paid by industrial companies on their preference shares and debentures, the next question for consideration is as regards the trend of the long term interest rate in this country. That is, at what rate from year to year have industrial companies been able to issue their preference shares and debentures? An examination of all industrial joint stock companies—public or private would provide the answer to the question. Information for all the companies is not easily available; but we have examined the important industrial companies,* and constructed the following table which gives the average yield of new issues of preference shares and debentures from year to year:—

* Reference was made to Investor's India Year Book, Calcutta Stock Exchange Year Book, Bombay Investor's Year Book, Investor's Encyclopaedia (Southern India Investor's Year Book), 'Capital' and 'Commerce.'

AVERAGE YIELD OF NEW ISSUES OF PREFERENCE SHARES AND DEBENTURES.

Year.	Preference Shares.		Debentures.	
	Yield %	No. of issues.	Yield %	No. of Issues.
1917	7·00	3	7·00	1
1918	6·41	6	6·50	1
1919	7·05	9	7·00	1
1920	6·78	9	5·00	1
1921	6·75	2	6·00	1
1922	10·00	2	5.33	3
1923	7·25	2	7·50	1
1924	8·00	1	7·00	3
1925	5·87	4	6·50	3
1926	7·50	1	......	...
1927	6·50	2	5·50	1
1928	7·30	5	5·00	1
1929	6·00	1	5·75	3
1930	6·50	2	6·00	1
1931	6·82	3	6·00	1
1932	7·25	2	5·81	4
1933	7·00	6	6·14	7
1934	6·37	4	5·10	5
1935	5·80	5	7·16	6
1936	5·66	6	5·52	13
1937	5·50	6	5·30	11
1938	6·25	5	5·22	12
1939	6·00	4	5·20	7
1940	5·50	3	4·96	7
1941	6·00	2	5·43	4
1942	5·16	3	5·97	6
1943	5·32	4	5·00	5
1944	5·08	6	4·66	3

In order to draw attention to the limitation of the table we have given the number of issues also. Although it is difficult to make any broad generalization, we may observe that a slight downward trend in the yield will be noticed especially after 1933, and the tendency is more pronounced in the case of debentures.

COST OF MAKING THE ISSUE.

We now turn to the second item in the price of new industrial capital, *viz.*, the cost of making the issue. The cost of making an issue would include: (1) legal charges incurred in drawing up the Memorandum, the Articles of Association and the Prospectus, (2) stamp duty and registration fees in connection with the registration of the company, (3) valuers' and accountants' fees, (4) advertising expenses incurred in connection with the advertisement of the Prospectus, (5) underwriting and over-riding commission,—in those cases where the issue is underwritten, (6) brokerage, that is, commission paid to stock brokers for placing the shares amongst the investors, and (7) other sundry charges. These expenses really form the preliminary expenses or expenses of issue incurred in connection with the flotation of a new enterprise. It will be seen that the remuneration paid to promoters, prospecting expenses, etc., are not included in preliminary expenses. But in the balance sheets of many new company flotations it will be found that these expenses are wrongly included under this head.

The advantages of keeping the expenses of issue low are obvious. If as much as 10 to 15 per cent of the

capital raised by a new company is spent on preliminary expenses, it starts with so much less capital and hence is liable to suffer from lack of sufficient finance. Some expenses like stamp duty and registration fees in respect of the registration of the new company have necessarily to be incurred. But other costs like the legal charges incurred in connection with the drawing up of the Memorandum, the Articles of Association and the Prospectus, can be kept low. As the joint-stock form of industrial organisation develops, the Memorandum and Articles of Association of companies become standardised and hence it should be seen that the fees charged by solicitors regarding this item are not high. So also the fees charged by solicitors in connection with the drafting of the Prospectus. Greater publicity is no doubt essential in the case of the advertisement of the Prospectus; indeed, the listing requirements of stock exchanges lay down that the Prospectus should be properly advertised. The rates of advertisement of Prospectuses in financial papers are not cheap. However, every attempt should be made to keep these expenses also within moderate limits. As regards the underwriting commission and brokerage paid in connection with the issue, these vary in accordance with the established practice and the state of development of the capital market concerned. Underwriting commissions also vary according to the form and quality of the issue, that is, whether ordinary or preference shares, or debentures are issued, or whether the management of the concern is in the hands of experienced persons or not. Concerns on whose boards of directors are to be found experienced busi-

nessmen and industrialists and, as in India, which are under the management of well known firms of managing agents will be able to get their issues underwritten at favourable rates. On a bigger issue, the underwriting commission would be lower than on a smaller one. On preference shares and debentures the underwriting commission would be smaller than on an issue of ordinary shares. In England, in general the underwriting commission is about 1 to 4½ per cent.* Smaller issues have to pay more in that country.† In the case of India, as already referred to in an earlier chapter, underwriting of issues was not much in vogue until recently. But in the last few years, underwriting and sub-underwriting of new issues has been undertaken by Investment Companies and Investment Trusts, as well as also by a few Commercial Banks and Insurance Companies. Our study of the more important recent company flotations shows that the underwriting commission has been between 1 and 5 per cent and that concerns sponsored by well known managing agency firms have been able to get their issues underwritten at 2 to 3 per cent.‡ But other issues had to pay more. Preference issues have been underwritten at more

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* See B. Ellinger : The City, p. 291.

† See A. T. K. Grant : A Study of the Capital Market in Post-war Britain, 1937.

‡ For example, in the case of Tata Chemicals, Ltd. (promoted in 1939 by the well known firm of Tata Sons, Ltd.)—both the ordinary and preference shares were underwritten at a commission of 2 per cent by the Investment Corporation of India, Ltd. In the case of the Steel Corporation of Bengl, Ltd. (promoted in 1937 by the well known Calcutta firm of Burn and Co.) the preference and ordinary shares were respectively underwritten at a commission of 2 and 2½ per cent by Burn and Co., the Indian Iron and Steel Co., Ltd, and Place, Siddons and Gough of Calcutta. In the case of Dalmia Cement, Ltd. (promoted by the well known industrialist Mr. R. K. Dalmia in 1937) the preference and ordinary shares were underwritten at a commission of 1 and 2½ per cent respectively by Place, Siddons and Gough. The preference shares of the Alkali and Chemical Corporation of India, Ltd. (floated in 1938) were underwritten by Imperial Chemical Industries (India) Ltd. (which had also promoted the concern), without the payment of any commission. The preference and ordinary shares of Anil Starch Products Co., Ltd. (promoted in 1939 by the well known Ahmedabad managing agency firm of Kasturbhai Lalbhai and Co.,) were underwritten at a commission of 2 per cent by the Investment Corporation of India, Ltd. The ordinary and preference shares of Hind Cycles, Ltd. (promoted in 1939 by the well known firm of Birla Bros. Ltd.) were underwritten at a commission of 2 and 1½ per cent respectively, by a group of stock brokers.

favourable rates than ordinary issues.* In view of the fact that the capital market is not much developed in India, the underwriting commission does not seem to be high. Reference has been made above to the underwriting commission paid in England. In spite of the existence of a well developed capital market in the United States, the underwriting commission charged by Investment Banks and Investment Houses in that country is fairly high. In a study of the underwriting commission on public offerings of bonds and stocks during 1933-37 for 307 bonds issues the commission worked to an average of 2.24 per cent, for 93 preferred stocks issues 3.58 per cent, and for 175 common stocks issues 14.40 per cent.† The high underwriting commission paid on common stocks will be very noticeable. Owing to the fact that the underwriting commission is not high in India, the expenses of issue of new company flotations are not much burdened by this charge.

As regards brokerage, that is, the commission paid to stock brokers who place the shares amongst the investors, most companies in India make provision for the payment of this commission as they find that stock brokers with their established clientele are able to place the shares easily. Even when an issue is underwritten, a commission to brokers may be paid, this being either paid by the company or by the underwriters. It is not very essential for a company to pay brokerage, if it feels confident that it can place the entire issue without the help of brokers. But in that

* For examples see previous foot-note.

† See T. K. Haven : Investment Banking under the Securities Exchange Act, pp. 19 & 23.

case it will find that it may not be able to get a quotation for its shares on certain stock exchanges. In accordance with the established practice of certain stock exchanges (*e.g.* the Calcutta Stock Exchange), the payment of a commission is made obligatory to stock brokers who help to place the issue; otherwise, the issue will not be listed on the exchange. But this commission is not much, as on an average it comes to about 1 to 2 per cent, and hence would not increase the preliminary expenses of a new issue.

As most industrial companies are floated in India under the aegis of managing agents, the more reputable among them, especially, have been careful to see that preliminary expenses or the expenses of issue are kept low. In this regard we may refer to the conditions in the London Capital Market, where attention has been drawn to the high expenses of issue and underwriting. The London Economist's analysis of issues in 1933-35 showed £4.1 million out of a total of £77.8 million going in underwriting and issue expenses, or 5.3 per cent. In individual cases preliminary expenses (including underwriting commission) came to from 13 to 14 per cent.* We may refer here to the more important recent industrial flotations in India in order to bring attention to the fact that preliminary expenses are kept low in this country. In the case of the Steel Corporation of Bengal, Ltd. (managing agents—Burn and Co.), the preliminary expenses, including underwriting and overriding commissions, came to Rs. 17.93 lakhs, or 3.5 per cent of the total capital raised,

*See A. T. K. Grant: Op. Cit., p. 169.

including debentures, *viz.*, Rs. 5.03 crores. In the case of Tata Chemicals, Ltd. (managing agents—Tata Sons, Ltd.), the preliminary expenses came to Rs. 3.48 lakhs, or 2.7 per cent of the issued capital, *viz.*, Rs. 1.25 crores. In the case of another chemical concern, *viz.*, the Alkali and Chemical Corporation of India, Ltd. (promoted by Imperial Chemical Industries (India) Ltd.), the preliminary expenses came to only Rs. 56,720 or .7 per cent of the issued capital of Rs. 74.40 lakhs. The very low preliminary expenses in the case of this important industrial undertaking must be noted; no remuneration was paid to the promoters, and though the preference shares were underwritten, no underwriting commission was paid. The preliminary expenses of Anil Starch Products, Ltd. (managing agents—Kasturbhai Lalbhai and Co.), came to about Rs. 28,000 or 2.8 per cent of the issued capital of Rs. 10 lakhs. In the case of Dalmia Cement Co., Ltd. (managing agents—Dalmia, Jain and Co., Ltd.), the preliminary expenses exclusive of the brokerage, as estimated in the Prospectus, were Rs. 1.20 lakhs, or 1.2 per cent of the issued capital of Rs. 1 crore. Similarly in the case of another cement flotation, *viz.*, the Assam Bengal Cement Co., Ltd. (managing agents—the Eastern Corporation, Ltd.), the preliminary expenses came to Rs. 31,000 or 0.9 per cent of the issued capital of Rs. 35 lakhs.

To conclude this section of our study of the price of new industrial capital in India: If we take interest up to 6 per cent as the reasonable rate which industrial concerns can pay to borrow capital by the issue of

preference shares or debentures (of course, making allowance for the payment of higher rates in those cases where greater risks are involved), our study will have shown that industries in this country have been able to raise capital at better rates by the issue of debentures than by the issue of preference shares. Can we take it from this that the prejudice against debentures seems to be dying? It is well known that in this country debentures have been unpopular with the investors. It is mistakenly believed by the Indian investor that a concern issues debentures only when it is in difficulties. In regard to preference share issues, it must be pointed out, however, that many of them were issued in the first two decades of the present century when the capital market was yet undeveloped and industrial development had not advanced much. On the other hand most of the debenture issues have been made only in recent years.

CHAPTER VI.

CONTROL OF CAPITAL ISSUES.

OBJECTIVES AND WORKING OF THE CAPITAL ISSUES CONTROL ORDER.

A study of the working of the New Capital Issue Market in India would be incomplete without a reference to the Control of Capital Issues now in operation in this country. The Control of Capital Issues Order which was issued on the 17th May 1943 under the Defence of India Rule No. 94-A, formed part of the Government's anti-inflationary drive. There was a steep rise in the general level of wholesale prices in India beginning from April 1942 and which continued during the rest of that year and the first half of 1943. Between March 1942 and December 1942, the index number of wholesale prices in India (compiled by the Office of the Economic Adviser to the Government of India, with 19th August 1939 as the base) rose from 144 to 185. Prices during the first quarter of 1943 showed an alarming rise and caused distress to the poorer sections of the community. The rise in prices was aggravated by speculation in the stock and commodity markets, as well as by widespread hoarding and transport difficulties which caused prolonged scarcities. The Economic Adviser's index rose during these months from 190 in January 1943 to 214 in March. The Government of India had to take a serious view of the rise in prices and devise measures to control speculation and otherwise to arrest the rise in prices and maintain supplies essential to the life of the community. Already on the 17th March 1943,

the Finance Member, the Hon'ble Sir Jeremy Raisman, speaking in the Legislative Assembly had warned the speculators in the cotton market that Government would mobilize all their resources to defeat their activities. On the 1st April 1943, the Government of India issued a Press Note stating that they contemplated taking measures intended to lead to a comprehensive scheme of cloth and yarn control and also that they proposed to prohibit futures trading in the new cotton crop. In pursuance of this decision the Government of India issued on the 1st May 1943, the Cotton (Forward Contract and Options Prohibition) Order whereby forward contracts and options in respect of new crops and options were prohibited. As the Order did not produce the desired result, the Cotton (Forward Contracts in Current Crops Prohibition) Order was issued on the 19th May extending the prohibition in forward trading to current crops. On the 17th May 1943, two more anti-inflationary measures were taken by the Government of India, *viz.*, the issue of the Excess Profits Tax Ordinance which provided for a summary assessment of wartime industrial profits and aimed at immobilizing a part of the surplus purchasing power in the hands of industrial concerns, and the issue of the Control of Capital Issues Order under the Defence of India Rules. These measures were followed up by the issue during the latter half of May of the Oilseeds (Forward Contracts Prohibition) Order whereby forward trading in groundnut, mustard seed and rape seed or toria seed was prohibited, and the Bullion (Prohibition of Forward Trading) Order.

The Control of Capital Issues Order prohibited :

(1) Without the prior consent of the Central Government—

(*a*) an issue of capital in British India,

(*b*) any public offer of securities for sale in British India,

(*c*) the renewal or (postponement of) repayment of any security maturing for payment in British India.

(2) Without the prior consent of the Central Government an issue of capital anywhere, whether within or without British India, by any company incorporated in British India ;

(3) The issue in British India of any prospectus or other document offering for subscription or publicity offering for sale any security which does not include a statement that the consent of the Central Government has been obtained to the issue or offer of the security ; and

(4) Subscription for any securities issued by the company in respect of any issue of capital made in British India or elsewhere unless such issue has been made with the consent of the Central Government.

While the main object of the Control of Capital Issues Order was to prevent the growth of mushroom

companies on the basis of the circumstances then existing, *viz.*, an abnormal boom in industrial shares, it also sought to encourage the formation of industrial concerns which directly assisted in aiding the war effort or would be in a position to embark upon production of essential consumers' goods which were then in scarce supply at an early date. Further, it was thought that by preventing the formation of all sorts of industrial enterprises, savings would flow into Government loans. These objectives no doubt were short term at the time of the issue of the Control Order. But they were subsequently broadened as a result of the working of the Order and with the end of the war in sight. One of the new objectives of the Control was to further the industrialization of this country on sound lines. The procedure in respect of applications for issues of capital for long range schemes was also relaxed, so as to allow issues of capital for such purposes with some freedom even if the schemes were still in an indefinite form.

The Control of Capital Issues Order has now been in operation for three years. Since the inception of the Control Order on the 17th May 1943 up to the 30th September 1945, the amount of capital applied for in India (including the Indian States) was Rs. 385 crores in respect of 4,660 companies. The total of amounts for which consent was given was Rs. 260 crores (3,784 companies) and of amount refused Rs. 89 crores (876 companies). It should be mentioned that this amount refers only to complete refusals; partial refusals are not included. Of the consents Rs. 160 crores

(1,766 companies) related to Industrial applications (of which Rs. 82 crores were "long range"). Of the consented applications, *viz.*, 3,784, 2,118 for an issue of Rs. 162 crores related to initial and 1,666 for an issue of Rs. 98 crores to further issues. Of the consented industrial issues, 961 applications for a capital issue of Rs. 102 crores, belonged to initial and 805 applications for an issue of Rs. 57 crores to further issues. Of the consented non-industrial applications, 1,157 in respect of Rs. 60 crores were concerned with initial and 861 applications in respect of Rs. 41 crores with further issues. Of the long range schemes consented, 182 applications for an issue of Rs. 67 crores belonged to initial and 65 applications for an issue of Rs. 27 crores to further issues. In respect of such industrial schemes, 158 applications for an issue of Rs. 60 crores related to initial and 58 applications for an issue of Rs. 22 crores to further issues. As regards such non-industrial ones, 24 applications for an issue of more than Rs. 7 crores belonged to initial and 7 applications for an issue of about Rs. 5 crores to further issues.

Continuance of Control of Capital Issues.

The Control of Capital Issues as we have seen above was necessarily a war-time measure. But now that the war is over the question arises as to whether the control over capital issues should be continued in the post-war period. There is bound to be some controversy over this question and a decision can be arrived at only after a careful examination of the whole position. It must be noted that conditions in India

at the present time are far from normalcy and the need, therefore, for the continuance of the control during the transition period will become obvious. Even thereafter in a planned economy which is envisaged for this country, there would be a definite need for the regulation of investment into proper channels and hence the necessity for control of capital issues. We have already seen in Chapter I that in England under the Labour Government's scheme of planned investment, the control would be exercised through the New Issue Market, that is, by the continuance of the Capital Issues Committee. The working of the Capital Issues Control Order in India for the last three years has shown that it has many advantages to offer, and there is much it can do to ensure a better working of the New Issue Market in this country. There would of course be some controversy as regards the exact scope and powers of the Capital Issues Control in the post-war period. But it would be admitted on all hands that the pace of industrialization of this country can be accelerated on healthy lines if proper control can be exercised in preventing the starting of industrial enterprises in over-crowded lines as well as in preventing the concentration of industries in particular regions. Indirectly, therefore, in scrutinizing applications for new issues of industrial concerns, control will be exercised over the location of industries and the flow of investments into certain channels. These will be the broad objectives of Capital Issues Control. There are other functions which may also be usefully performed. For example, in granting consents to new issues, some guidance under the Capital Issues

Control can be given as regards the capital structure of particular industrial concerns. At the same time the issue of certain types of securities, *e.g.*, deferred shares with rights so arranged that holders of a small number of these shares exercise complete control over the company concerned, should be prevented.* Some of the functions envisaged no doubt fall within the purview of expert Issue and Investment Houses; but in the absence of sufficient numbers of these expert institutions at the present time in India some of their functions as mentioned above will have to be performed by some other agency.

Conclusion.

This study has been mainly concerned with a description of the actual working of the New Capital Issue Market in this country. It will have been seen that the New Issue Market in this country stands no comparison with the organized New Issue Markets in England and the U.S.A. with their well developed institutions such as Issue and Investment Houses, Investment Banks, Investment Trusts, etc., who specialize in the work of promotion of new companies and the underwriting and marketing of their securities. Though much appreciable progress

*Under Section 5(*a*) of the revised form of questionnaire issued by the Capital Issues Committee in England, those seeking permission to raise new capital have to give information in regard to " the exact amount (in figures) of shares, debentures and other security it is desired to issue at the present time for cash " and a " description of the shares (or other securities) to be issued showing whether they are to be redeemable." Cf. " Economist "—June 30, 1945. The information which has to be given under Section 5(*a*) of the questionnaire and which would enable the Capital Issues Committee to control the form of issue has, however, been considered by the "Economist" as undesirable in itself, since one of the important functions of the board of directors concerned should be the arrangement of a financial structure fitted to the particular enterprise and to the state of the capital market. See " Economist," August 11, 1945, p. 205.

has been made in recent years in India in regard to the establishment of Issue Houses, Investment Trusts, etc., much remains to be done. The brunt of the work of promotion of new industrial concerns and the raising of their capital has been done by the Managing Agents, whose services in the industrial advancement of this country cannot be minimized. The New Issue Market is the pivot, as it were, of the Investment Market of any country. In the planning of investment there is no doubt that the reorganization of the New Capital Issue Market will receive its due share of attention. A well developed New Capital Issue Market will make our industrialization easier and further the economic advancement of this country.

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(The letter 'n' after a figure denotes a footnote)